Supreme Court, U.S.
FILED
DEC 12 1985
JOSEPH F. SPANIOL, JR.
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85-1030 (1)

No. 85-

In the Supreme Court of the United States

OCTOBER TERM, 1985

IRVING AND CHARLOTTE RADOL, *et al.*,

Petitioners,

vs.

W. BRUCE THOMAS, *et al.*,

Respondents.

On Writ of Certiorari to the
United States Court of Appeals for the
Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

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105 PP

QUESTION PRESENTED

Can asset valuations prepared in accordance with routine industry standards and practices be material to target company shareholders in a tender offer?

PARTIES TO THE PROCEEDINGS

Petitioners are Irving and Charlotte Radol, A. James Ibold, Dwight C. Baum, the Crosset Charitable Foundation, Reuben A. Fishbein, Trustee, and Robert C. Utley, on behalf of themselves and all former shareholders of respondent Marathon Oil Company at the time of a tender offer for a majority of Marathon shares by respondent U.S. Steel Corporation in November 1981 and the subsequent March 1982 freeze-out going private merger when Marathon became a wholly-owned subsidiary of U.S. Steel. Petitioners are plaintiffs and were appellants below.

Respondents are W. Bruce Thomas, William R. Roesch, David M. Roderick, United States Steel Corporation, USS Inc., USS Holdings Company, USS Merger Sub, Inc., Goldman Sachs & Co., Marathon Oil Company, Harold D. Hoopman, Charles H. Barre, Elmer H. Graham, W.E. Swales, Jack H. Herring, Victor G. Beghini, Neil A. Armstrong, James A.D. Geier, J.C. Haley, J.N. Land, Jr., Raymond C. Tower, Robert G. Wingerter, and the First Boston Corporation. Respondents are defendants and were appellees below.

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Petitioners, Irving and Charlotte Radol, A. James Ibold, Dwight C. Baum, the Crosset Charitable Foundation, Reuben A. Fishbein, Trustee, and Robert C. Utley, on behalf of themselves and similarly-situated former shareholders of the Marathon Oil Company respectfully pray that a writ of certiorari issue to review the judgment of the Court of Appeals for the Sixth Circuit entered on September 13, 1985.

OPINIONS BELOW

The opinion of the court of appeals is reported at 772 F.2d at 244 and appears as Appendix A hereto. A companion opin-

ion decided the same day which treats the same subject matter and further explains the bases for the court's judgment is reported at 772 F.2d at 231 as *Starkman v. Marathon Oil Co.* (hereinafter "*Starkman*"), and appears as Appendix B. The opinion of the district court on motion for summary judgment is reported at 556 F. Supp. 586, and appears as Appendix C.

JURISDICTION

The judgment of the Court of Appeals was dated and entered on September 13, 1985. Jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides in pertinent parts:

> It shall be unlawful for any persons, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e) of the Williams Act, 15 U.S.C. §78n(e), provides in pertinent part:

> It shall be unlawful for any person to make any untrue statements of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connec-

> tion with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

SEC Rule 10b-5, 17 C.F.R. §240.10b-5, provides in pertinent part:

> It shall be unlawful for any persons, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

A. Introduction

This is a class action under the federal securities laws, which arises out of the extinction of the rights of thousands of class members who held shares of the Marathon Oil Company when it was acquired by the United States Steel Corporation in a friendly tender offer in November, 1981 and subsequent freeze-out merger pursuant to proxy statement and prospectus dated February 8, 1982. The district court had jurisdiction under 28 U.S.C. §§1331 and 1337.

The major issue in the litigation is whether either or both of two extensive and expert valuations of Marathon's assets should have been disclosed to the shareholders at the time of the November, 1981 tender offer. One of the valuations was prepared by Marathon's investment advisor, and known as the First Boston Report. The other was prepared by Marathon

itself, and known as the Strong Report. Both were completed just before U.S. Steel's tender offer. Both were given by Marathon's management to U.S. Steel at the beginning of their negotiations. Both were concealed from the shareholders at the time of the tender offer.

The Sixth Circuit held that valuations of assets, including the First Boston and Strong Reports, are not material and thus need not be disclosed to shareholders under the federal securities laws unless they can be calculated with "substantial certainty." Since asset valuations must involve judgment the holding means that such valuations need never be disclosed. This is true even though the uncontradicted evidence at trial was that experts in the securities industry and the oil and gas industry regularly rely upon this type of valuation in making decisions whether to purchase or sell such assets. Similarly, the Sixth Circuit also held that the failure to disclose projections of earnings from such assets (which both Reports necessarily contained) can never violate Rule 10b-5 or the Williams Act, no matter how reasonable the bases for the projections. The district court gave what was in essence a directed verdict that the First Boston and Strong Reports should not have been disclosed. The Sixth Circuit affirmed on appeal, explicitly holding that a directed verdict was required.

The court below acknowledged that its standard was in direct conflict with one recently articulated by the United States Court of Appeals for the Third Circuit in *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (3d Cir. 1984) (hereinafter sometimes "*Flynn*").

The holding below is also in direct conflict with the standard of materiality enunciated by this Court in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1978) (hereinafter sometimes "*TSC*"). There the Court explained that "an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important. . . ." *Id.*, at 449.

Indeed, just last Term, the Court reemphasized that the federal securities laws are premised upon full disclosure.

Schreiber v. Burlington Northern, Inc., 53 U.S.L.W. 4655 (U.S. June 4, 1985).

It was critical for Marathon shareholders to learn of the First Boston and Strong Reports at the time of the U.S. Steel tender offer. In the fall of 1981, Marathon's management faced a hostile tender offer at $85 per share from the Mobil Oil Company. To rescue itself, it agreed to a tender offer by a "white knight," U.S. Steel. Marathon's management agreed that U.S. Steel would obtain 51% of the Marathon shares pursuant to a tender offer for $125 per share, and the remaining 49% of the shares for debentures that, when issued, traded for $76 per share. Thus the "blended" price approximated $100 per share, and shareholders who did not tender at all received only $76 per share.[1]

The First Boston Report, completed just before these events, concluded that Marathon's net assets were worth between $188 and $225 per share. The Strong Report concluded that the net assets were worth $276 to $323 per share. Both demonstrated that Marathon's assets were worth substantially more than U.S. Steel's price.

Marathon's management gave U.S. Steel copies of the First Boston and Strong Reports, but did not disclose their existence or their contents to the shareholders. U.S. Steel's tender offer did not disclose the existence or contents of either Report. Instead, within a period of 17 days, Marathon's President wrote three letters to Marathon shareholders stating that the Mobil offer was "grossly inadequate" and was an attempt to "seize control of Marathon's assets at a fraction of their value," but that the U.S. Steel offer was fair, and therefore did represent the value of these assets.

Disclosing the First Boston or Strong Reports would have undermined the credibility of these letters with respect to the purported fairness of U.S. Steel's price. It would also have provided the shareholders with the information and tools

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1. U.S. Steel said it expected the debentures to trade at $86 per share, and therefore to yield a blended price of $106 per share.

necessary to evaluate the fairness of U.S. Steel's offer—information which U.S. Steel itself received. For shareholders not to receive these documents in these circumstances contravened the very purpose and function of the federal securities laws. Yet the Sixth Circuit held that, as a matter of law, both Reports need not be disclosed.

This Court should review this decision for three reasons: (1) the standard applied below conflicts directly with the Third Circuit's decision in *Flynn*, (2) the holding as to materiality is patently incorrect under this Court's definition of "materiality" set forth in *TSC*, and (3) the issue is a recurring one of national importance, because of the number of tender offers involving not only the oil and gas industry but many other industries in which asset valuations may exist at the time of a tender offer. A fair, coherent, and consistent standard needs to be articulated as to when such valuations should be disclosed. Since the uncontradicted evidence was that investment analysts and others routinely consider valuations like those involved here to be important in making business decisions, the Court's resolution of this important issue of federal law will guide target companies, tender offerors, and the investing public.

This petition describes the two asset valuations in question, and then explains their significance in the context of the U.S. Steel/Marathon Oil friendly tender offer.

B. The First Boston Report

In July, 1981, Marathon's President instructed its investment banker and financial advisor, First Boston Corporation, to prepare a valuation of Marathon's assets. The purpose was to show how a third party with no access to "inside" information, but a vast command of all public information, would value the company. The 82-page single-spaced document which resulted was designated "confidential" by Marathon and became known as the First Boston Report.

The Report concluded that Marathon had an underlying asset value, net of liabilities, of $11.1 to $13.2 billion. This was in contrast to the $3.7 billion equity value reflected in

Marathon's stock prices, meaning that Marathon was significantly undervalued in the marketplace. First Boston determined an asset value per share of $188 to $225 as of July, 1981, compared with the price at which the stock traded, which ranged from $76 in January, 1981 to $45 in May, 1981 to $80 in July and back to $48 in September.

Most of these assets were in oil and gas reserves. "[T]he bulk of Marathon's asset value lies in its proven domestic hydrocarbon reserve base." Specifically, Marathon's oil reserves in the United States, including proved petroleum reserves of 682.9 million barrels, amounted to 49% of its total assets.[2] The Yates Field in Texas, the "crown jewel" of Marathon's assets, in turn accounted for one-half of Marathon's United States reserves, or approximately 25% of Marathon's total assets. First Boston concluded that Marathon's interest in the Yates Field was worth from $2.7 billion to $3.6 billion. Thus, as First Boston set forth in its Report, this one asset alone—representing only 25% of Marathon's total assets—was worth as much as or more than *the total market value of the company's stock*:

> "[I]t is apparent that the value of the Yates holding alone approaches or exceeds the $3.7 billion market value accorded the Marathon equity by investors in recent trading."

First Boston repeatedly emphasized that its approach to valuation was "conservative." Indeed, the major subheading of the report was "*Conservative* Oil and Gas Valuations Based on Public Information." (Italics supplied.) In its section on Mar-

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2. The First Boston Report was conservative in focusing only on "proven" reserves and "probable" reserves, the latter of which were estimated at 20% of proven quantities, and then discounted 40% for implicit risk. (The net effect was to add 12% to the value of the proven reserves—60% of 20% = 12%) The First Boston Report assigned *no* value at all to a third, more speculative type of reserve known in the industry as "possible" reserves. Similarly, First Boston assigned no value to reserves which were in the process of exploratory drilling.

athon's natural gas reserves, it accepted for purposes of the report what it described as "low 'pessimistic' case factors."

First Boston applied its resources and expertise in the analysis of the data thus collected:

> "Behind our per barrel and mcf reserve values stands the output of First Boston's computer simulation model which incorporates implicitly parameters as to price, expenses, windfall, severance and other taxes, and other items. For natural gas reserves, we have also examined the impact of under-accelerated decontrol such as the Gramm Bill."

First Boston's methodology in valuing oil and gas reserves was to apply a "discounted cash flow approach with a 15% discount rate," meaning that future net cash flow was projected, and then "discounted" to arrive at a figure representing the present value of the ability to obtain such future earnings. For the Yates Field, three specific detailed cash-flow models were prepared, using a 7% inflation rate for oil prices. First Boston stated that this method of valuation was consistent with methods generally used in the industry. "[T]he values attributed to oil and natural gas reserves were based on our experience with representative petroleum properties. . . ."

Marathon's President testified that the discounted cash flow method was the standard method used in determining the current value of oil and gas properties. Similarly, U.S. Steel's Vice President for Corporate Strategic Planning testified that the "discounted" or "present value" method of valuing oil and gas reserves was the key factor in valuing oil and gas company securities. Marathon's world-wide oil and gas reserves[3] were each separately and carefully valued in this manner by First Boston for an aggregate value of oil and gas reserves of between $9.218 billion and $11.347 billion.

Marathon's President's description of his negotiations

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3. Including the Texas fields discussed above and Marathon reserves in Wyoming, Alaska, Louisiana, New Mexico, North Dakota, Utah, the Gulf of Mexico, the North Sea, the Celtic Sea, Libya, Abu Dhabi and Nigeria, the latter three accounting for a very small percentage of the reserves.

with U.S. Steel's President mirrored the data and analyses of the First Boston Report, which further demonstrated that the Report was a reliable reflection of what these two Presidents deemed "material" in the industry:

> "We talked about whether the output of the Bray [sic] field under the tax law in the UK would generate enough funds to justify the kind of price we were trying to get for the stock, when combined with the output from the Yates field, the refining and operating profits or losses, or however you want to look at it, what the variations were, and what the hazards were, how the windfall profit tax was going to impinge on the value of that barrel that is going to be produced out of one of the old fields. These are the kinds of things we talked about."

The First Boston Report at pp. 24-25 analyzed the North Sea Brae Field; at pp. 6-15, the value of the output from the Yates Field; at pp. 28-31, the refining and marketing operations, and at p. 15, the percentage classification of Marathon's "old oil," and the percentage impact of the three tiers of the windfall profit tax.

In addition, Marathon had more than $2.2 billion in "above ground" refining, marketing, and transportation assets, including four refineries in which Marathon had recently expended $750 million for expansion and upgrading. First Boston's conservative approach to valuation was further evident here, as it determined that comparable plants had recently been sold for a price based upon capacity per day which ranged between $1,000 and $4,000 per barrel per day. First Boston ascertained the replacement cost of Marathon's refineries at $6,000 to $7,000 per barrel per day. Nevertheless, First Boston valued the refineries at a range of $1,000 to $3,000 per barrel per day, lower than the market range.

C. The Strong Report

In July, 1981, simultaneously with instructing First Boston to prepare its Report, Marathon's President and its General Counsel instructed the Marathon department heads to

prepare an asset valuation using all information available to them. The 664 page document which resulted was also labeled "confidential" by Marathon, and became known as the "Strong Report" after J.F. Strong, the Marathon employee who organized it.

Marathon's general counsel requested Marathon's top level executives to obtain valuations of the assets within their areas of responsibility. A typical request stated:

> ". . . would you please furnish to me personally *your best opinion of the present market value of the Company's oil and gas reserves within your area of responsibility*, including, without limitation, proven reserves, probable reserves, possible reserves, and reserves which could be reasonably attributed to the Company's undeveloped acreage." (Italics supplied.)

Whereas First Boston concluded that the assets, net of liabilities, had a value range of $11.1 billion to $13.2 billion, the Strong Report concluded that the net assets had a value of $16.188 billion to $18.917 billion. Divided by the number of shares, this represented a per share value of $276 to $323.

The Strong Report explained its method for valuation as follows:

> "An internal evaluation of the assets of Marathon Oil Company has been completed as of June 30, 1981. . . . This appraisal was performed utilizing the 'Discounted Cash Flow' method on those assets which have sufficient data available. All other assets are appraised at current value, replacement or book value utilizing judgment decisions of the management of the respective companies."

Whereas the First Boston Report included only "proven" and "probable" oil and gas reserves, the Strong Report also included a third and fourth category, "possible" reserves and "reserves which could be reasonably attributed to the company's undeveloped acreage." And whereas First Boston used a steeper 15% discount rate for discounting the projected cash flow back to present value, the Strong Report used a

mixture of 12% and 15%. And the Strong Report used replacement cost as the basis for all of the above-ground assets (refining, marketing, and transportation), which yielded higher valuations than First Boston's approach. Nevertheless, these values represented the best determination by the high-level officers and employees of Marathon as to the value of Marathon's assets, prepared in the manner routinely used in the industry for valuing such assets. And the head of Marathon's Economics Department testified that all data provided by his department for the Strong Report were prepared by standard methods, free of any "optimistic" or other bias.

D. The Mobil Oil and U.S. Steel Tender Offers for Marathon

On October 30, 1981, three months after the First Boston and Strong Reports were commissioned, the Mobil Oil Company announced a hostile tender offer for 40 million Marathon shares at a price of $85 per share. Mobil proposed a subsequent going-private merger in which the remaining Marathon shareholders would receive a debenture also worth $85 for each Marathon share.

The next day, October 31, 1981, Marathon's Board of Directors met. First Boston presented its $188-$226 per share valuation. Mr. Strong presented the valuations of $276 to $323 per share contained in his Report. Based on these presentations and documents, the Marathon Board determined the Mobil offer to be "grossly inadequate." Marathon's President sent Marathon shareholders two letters, on November 2 and November 12, 1981, urging the shareholders to reject the Mobil offer and emphasizing the importance of the asset values in this determination of "gross inadequacy":

> "[Y]our board of directors is convinced that the Mobil offer is grossly inadequate **and does not represent the real values of the assets underlying your investment in Marathon.**" (Bold type in original.)

He did not disclose the existence of, or the per-share valuations or any other contents of, the First Boston or Strong

Reports. The second letter further stated: "We urge you to reject this attempt to seize control of Marathon's assets at *a fraction of their value*."[4] (Italics supplied.)

In June, 1981, U.S. Steel had internally stated that it was seeking to acquire "significantly undervalued ... energy" companies. On November 9, 1981, U.S. Steel telephoned Marathon to determine whether Marathon would be interested in a negotiated tender offer, a merger, or a purchase of Marathon's assets by U.S. Steel. The Presidents of U.S. Steel and Marathon met on November 10th. Marathon's President gave U.S. Steel's President a complete copy of the First Boston Report, and a summary of the Strong Report. U.S. Steel signed a three-page letter agreeing to keep these documents confidential and acknowledging them to contain "*material* information". The confidentiality agreement under which both of these documents were supplied by Marathon's management to U.S. Steel's management stated that "Marathon has endeavored to include in the Evaluation Material *all material information known to it which it believes to be relevant for the purposes of your investigation*." (Italics supplied.)

On November 18, 1981, Marathon and U.S. Steel reached an agreement under which U.S. Steel would offer to purchase 30 million Marathon common shares, or 51%, in a tender offer for $125 per share. Subsequently, U.S. Steel would implement a freeze-out merger to acquire the remaining 49% shares, issuing debentures which it stated would trade at $86 per share, but which actually traded on the issuance date at $76 per share, and were booked by U.S. Steel at this amount. Thus, a Marathon shareholder could, at best, expect to receive $125 for half of his or her shares, and $76 for the remainder, for a "blended" price of $100 per share. However, if the shareholder did not rush to tender, he or she would

4. On November 25, 1981, Mobil issued a revised takeover proposal involving $126 per share cash for the initial tender, and merger consideration designed to be worth $90 per share. Marathon obtained a preliminary injunction restraining Mobil from proceeding with its tender offer on the grounds such a merger would violate the antitrust laws.

be forced to accept the $76 debenture for all of his or her shares at the "back-end" of this "two-step" offer.

The merger agreement between Marathon and U.S. Steel was concluded on November 18, 1981. On November 19th, U.S. Steel mailed its offer to purchase 30 million shares to all Marathon shareholders. This offer did not disclose either the existence of or the valuations contained in either the First Boston Report or the Strong Report. Indeed, the offer was affirmatively misleading in creating the impression that the only material non-public information which had been provided by Marathon to U.S. Steel were certain earnings and cash flow projections which were disclosed in the Offer to Purchase.

On the same day, November 19th, Marathon's President again wrote to all Marathon shareholders, stating that the Marathon Board had determined the U.S. Steel price to be "fair," and urging the shareholders to tender. Seven days earlier, on November 12th, he had written to all shareholders that Mobil's $85 per share offer was "grossly inadequate" and did not represent the "real value of the assets." Now, U.S. Steel's blended price was urged as a price which did reflect the real value of those assets. The President's letter did not disclose the existence of or the valuations contained in the First Boston Report or the Strong Report, both of which would have seriously undermined the credibility of the rest of the letter. Shareholders were not apprised that First Boston, using conservative assumptions and facts of public record, had concluded that each Marathon share was worth between $188 and $226, nor that Marathon's own department heads had determined the company's net assets to be worth $276 to $323 per share using valuation methods routinely employed in the industry.

The Agreement signed between Marathon's management and U.S. Steel on November 18th also prohibited Marathon from providing any information to any other company which might have been willing to make an offer to purchase Marathon shares at a price which was higher than U.S. Steel's

price. At the time Marathon accepted U.S. Steel's offer, it had received an oral offer from Gulf Oil Corp., under which Gulf proposed to acquire Marathon at an average price of $120 per share.

E. Completion of the Takeover

Because of the "two-tier" structure of U.S. Steel's tender offer, whereby anyone who did not tender would be relegated to receiving only $76 for all of his or her shares, 53,880,360 or 92% of the Marathon shares were tendered. U.S. Steel purchased 30 million, or approximately 51%, and therefore had majority control. On February 8, 1982, defendants mailed to Marathon shareholders a Notice of Special Meeting of Shareholders and Proxy Statement, to announce the March 11, 1982 shareholder vote on the merger. The proxy statement was also a prospectus of U.S. Steel in connection with the proposed issuance of the notes to complete the merger of U.S. Steel and Marathon. This proxy statement revealed for the first time the existence of the First Boston and the Strong Reports, and the per share valuations contained in these reports.

On March 11, 1982, the merger was approved at a special meeting of Marathon shareholders. A two-thirds vote of all shares issued and outstanding was required to approve the merger; less than two-thirds of the shares which were not owned by U.S. Steel voted in favor of the merger.

All tendering shareholders received debentures worth $76 per share for their remaining shares not purchased by U.S. Steel in the tender offer. Persons who had not tendered initially received *only* the debentures worth $76 per share, significantly less than the $85 per share which the Marathon board stated on November 12, 1981 to be "grossly inadequate."

F. The Evidence For and Against Materiality and Reliability of the First Boston and Strong Reports

At trial, plaintiffs presented evidence for, and defendants presented evidence against, the materiality and reliability of

the First Boston and Strong Reports. Plaintiffs demonstrated that: (1) both Reports were presented to the Marathon Board on October 30, 1981, when it made its determination that Mobil Oil's tender offer was "grossly inadequate" and was an "attempt to seize control of Marathon's assets at a fraction of their value"; (2) both Reports were given by Marathon's management to U.S. Steel at the beginning of their negotiations; (3) both Reports were deemed by Marathon and U.S. Steel to contain "all *material* information known to [Marathon] which it believes to be relevant for the purposes of your [U.S. Steel's] investigation"; (4) the First Boston Report stated repeatedly it was using conservative data and assumptions, and Marathon's head of economics testified the Strong Report contained data prepared by standard methods, free from any optimistic bias; (5) Marathon's President testified that the "discounted cash flow" method of valuing the oil and gas reserves was standard in the industry; (6) U.S. Steel's Vice President Corry testified that the discounted cash flow method of valuing oil and gas reserves was the one primarily used by securities analysts in valuing oil and gas securities; (7) U.S. Steel's Assistant Comptroller Hernandez, who also participated in the negotiations, testified that the Strong Report would be "relevant" to a decision to "sell off Marathon's assets," which plan he testified U.S. Steel had under consideration; (8) U.S. Steel relied upon the Strong Report in January, 1982 in approaching bond rating agencies to approve the debentures, by showing that its price for Marathon was "reasonable" because "an internal valuation by Marathon placed a total value on its oil and gas reserves alone of over $13 billion"; (9) plaintiffs' expert in securities analysis (Torkelsen) testified that a reasonable investor would consider both Reports to be important, and (10) plaintiffs' expert in oil and gas valuations and in such investments (Murray) testified that the Strong Report was an "excellent, comprehensive, thorough analysis of the assets of Marathon," and "very important" to shareholders trying to make a decision of whether to dispose of Marathon stock, and further testified that the First Boston Report was a valuable study which "would have been ex-

tremely difficult for anyone else to compile, even though it is based on publi[illegible]mation."

Defenda[illegible]al attempted to attack the credibility of the Reports, and to show these documents had not been relied upon as heavily as plaintiffs contended. Most of their attacks were directed toward the Strong Report rather than the First Boston Report. Defendants claimed: (1) that the Strong Report was an unduly optimistic "sales" document, particularly with respect to its projection of the future price of oil and its use of replacement cost for valuing the marketing, refining, and transportation assets; (2) furthermore, that the Strong Report (but not First Boston's) contained data on unproved "possible" oil and gas reserves; (3) that U.S. Steel's Vice President Corry did not rely upon the Strong Report in evaluating Marathon because he thought it was "a trumped up piece of junk," and that he did not disseminate it to U.S. Steel's President or the U.S. Steel Board; (4) that the Marathon-U.S. Steel negotiations were actually based upon five-year earning and cash flow projections rather than upon the First Boston or Strong Reports, and (5) that the deposition of one plaintiff read at trial (Ibold) reflected that he did not think 30 year projections of net income and cash flow could be reliable. (He was not testifying, however, about valuations, nor in particular about the First Boston or Strong Reports.)

Thus, a genuine conflict of the evidence existed, which was for the factfinders to resolve. However, the district court's instructions took this issue from the jury, and the Sixth Circuit affirmed, holding that as a matter of law no disclosure to shareholders of either Report should have been made.

G. The District Court and the Sixth Circuit Decisions

The district court initially denied summary judgment to the defendants on the question whether the First Boston Report and the Strong Report could have been material to a reasonable shareholder, and should have been disclosed during the tender offer. Applying *TSC Industries, Inc. v. Northway, Inc., supra*, the court held:

> "It is conceivable that a 'reasonable shareholder' would have accorded the valuations 'actual significance' in his deliberations, even if disclosure would not have altered his decision." 556 F.Supp. 586, 594; A62.

At trial, however, the district court did an about-face, and gave what amounted to a directed verdict for defendants. The instructions, which plaintiffs challenged in the court below, are three:

> [1.] "Representations concerning future sales, projections, forecasts and the like only rise to the level of materiality when they can be calculated with substantial certainty."
>
> [2.] "Only disclosure of existing material facts is required. Economic forecasts are not."
>
> [3.] "A failure to make known a projection of future earnings is not a violation of Rule 10b-5."

The court of appeals affirmed these instructions, making it clear that a directed verdict for defendants was required:

> "[U]nder our decisions, the District Court should have ruled that the reports were not material and removed the issue from the jury." 772 F.2d at 253; A16.

The court held that, as a matter of law, there was no duty to disclose these Reports or their contents:

> "[W]e have held . . . that there was no duty to disclose the asset appraisals at issue here."[5] 772 F.2d at 253; A15.

The court of appeals held that asset valuations and projections of income should not be disclosed unless they "*are virtually as certain as hard facts.*" *Starkman*, 772 F.2d at 241; A44 (italics supplied). The court further stated that all predictions underlying asset valuations and projections must be

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5. In *Starkman* the companion decision to the case herein, the Sixth Circuit affirmed a grant of summary judgment which also ruled that the First Boston Reports and the Strong Reports did not have to be disclosed as a matter of law.

"substantially certain to hold" before disclosure should be made, and gave as an example only one type of prediction which could possibly meet this standard: "a fixed plan of corporate activity." *Id.*

Thus, there is a categorical standard in the Sixth Circuit under which no asset valuation need ever be disclosed. For every valuation, by its very nature, involves human judgments as to value and at least an implicit assumption about the future. No such judgment can ever be as certain as a "hard fact." No such judgment can ever be as "substantially certain to hold" as a "fixed plan of corporate activity." And no "projection of future earnings" ever need be disclosed to shareholders, no matter how reasonable or adequate its bases or to what extent the target management and tender offeror themselves relied on that projection. Under the jury instructions approved here, failure to disclose projections, including the projections such as the discounted cash flow method of the First Boston and Strong Reports at issue here, can never violate Section 10(b) or the Williams Act as a matter of law. And all of this is irrespective of the extent to which a reasonable investor would consider the valuations and projections significant in the making of his or her investment decisions.

REASONS FOR GRANTING THE WRIT

POINT I

There is a Conflict between the Third and the Sixth Circuits on Whether Asset Appraisals and Forecasts Like those Here Can be Material and hence Required to be Disclosed.

The Sixth Circuit's categorical rule that the federal securities laws never require disclosure of asset valuation or income projections to shareholders of the target company in a tender offer is in direct and acknowledged conflict with the rule enunciated by the Third Circuit in *Flynn, supra. Flynn* also involved the issue of when asset valuations should be disclosed to shareholders of the target company in a tender offer. The Third Circuit held as follows:

> "[T]oday we set forth the law for disclosure of soft information as it is to be applied from this date on. Henceforth, the law is not that asset appraisals are, as a matter of law, immaterial. Rather, in appropriate cases, such information must be disclosed. Courts should ascertain the duty to disclose asset valuations and other soft information on a case by case basis, by weighing the potential aid such information will give a shareholder against the potential harm, such as undue reliance, if the information is released with a proper cautionary note.[17]
>
> "The factors a court must consider in making such a determination are: the facts upon which the information is based; the qualifications of those who prepared or compiled it; the purpose for which the information was originally intended; its relevance to the stockholders' impending decision; the degree of subjectivity or bias reflected in its preparation; the degree to which the information is unique; and the availability to the investor of other more reliable sources of information.
>
> "17. Some courts have approved the release of appraisal values with an appropriate disclaimer. *See, e.g., South Coast*, 669 F.2d at 1269; *Alaska Interstate*, 402 F.Supp. at 573."
>
> 744 F.2d at 988.

The court below acknowledged that its holding was in conflict with *Flynn* (and the cases cited in *Flynn*), stating, "The Third Circuit has enunciated a different test. . . ." 772 F.2d at 242; A45. The Sixth Circuit rejected *Flynn's* holding, as follows:

> "By its very nature, this sort of judicial cost-benefit analysis is uncertain and unpredictable. . . ." *Id.*

It approved its own approach because it "focuses on the *certainty* of the data underlying the appraisal or projection." *Id.*; A46 (italics supplied). The court further emphasized that its holding would never require the disclosure of asset valuations and projections of income. *Id.*

Thus there are two different legal standards governing the disclosure of asset valuations of the target company to shareholders of that company in a tender offer. That conflict is particularly troubling in the context of what is supposed to function as a national securities market. Given the volume of tender offers[6] in which asset valuations of the target company may exist, it is particularly important that there be a uniform standard to guide the target company, tender offerors, and the shareholders in ascertaining what should be disclosed.

If the case at bar had been litigated in the Third Circuit, the jury would have been instructed to assess the factors set forth in *Flynn* above to determine the "materiality" and the defendants' duty *vel non* to disclose the First Boston and Strong Reports. It would have been instructed to assess the evidence (which on certain points was conflicting, as set forth on pp. 14-16 above) as to what facts were used to compile each of the reports; who prepared them, and what their qualifications were; why the reports were prepared; whether they were relevant to the shareholders' decision to tender; whether either report reflected bias or subjectivity; whether the information contained in either report was unique; and whether the Marathon shareholders could have received more reliable information from another source. The jury also would have been asked to determine whether disclosure, if required, should also have required an explanation or warning as to assumptions made in either report, so that shareholders could have better evaluated the reports' conclusions. Under the *Flynn* test, a reasonable jury could have concluded that both the First Boston and the Strong Reports (or alternatively, either of them) should have been disclosed under the federal securities laws by either Marathon or U.S. Steel, or by both.

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6. From 1981 through 1984, there were 228 cash tender offers in which the bidders in fact acquired some or all of the shares they sought. "The Economics of Any-or-All, Partial, and Two-Tier Tender Offers," A Study by the Office of the Chief Economist, Securities and Exchange Commission (April 19, 1985), Table 1a. Of the ultimate offers for these cases, only 49 (or 21%) were non-negotiated, *i.e.*, hostile, tender offers. *Id.*, Table 1b.

Under the Sixth Circuit standard applied in this case, however, the jury was instructed that such reports should not have been disclosed as a matter of law. The Sixth Circuit's opinions make it clear that henceforth no such valuation should ever be disclosed in the Sixth Circuit because none, by its intrinsic nature, can have the "substantial certainty to hold" as a "hard fact" or a "fixed plan of corporate activity."

The outcome of major litigation should not depend on which circuit is the forum for that litigation. And the national securities market should not have to contend with fundamentally different legal standards as to this important and recurring issue.

For the foregoing reasons, plaintiffs respectfully request that a writ of certiorari issue.

POINT II

The Standard of Materiality Applied by the Court below is Inconsistent with this Court's Decision in *TSC Industries, Inc. v. Northway, Inc.* and Therefore Erroneous.

The Sixth Circuit's decision constitutes legal error under this Court's decision in *TSC Industries, Inc. v. Northway, Inc.*, *supra*.

In *TSC*, this Court clarified and enunciated the standard of materiality applicable in the context of disclosures under the federal securities laws.[7] There the Court stated:

> ". . . An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with [*Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970)] general description of materiality as a requirement that 'the defect have a significant *propensity*

7. While the Court was faced in *TSC* with the definition of "material" for purposes of §14(a) of the Securities Exchange Act of 1934, 15 U.S.C. §78n(a), the court below correctly determined that the same definition applies for purposes of §§10(b) and 14(e) and Rule 10b-5. 772 F.2d at 253; A14-A15.

> to affect the voting process.' It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

426 U.S. at 450 (italics in original; footnote omitted). Thus, the substantial likelihood is to be gauged in terms of how the investor would view the omitted factual information.

In dealing with the value of oil and gas companies, the principal asset involved is generally the company's reserves. Routinely these are valued by appraising what revenues those reserves will generate when the resources are pumped out of the ground, and then those future revenues are discounted to their present value. In appraising such assets, therefore, persons investing in oil and gas reserves (including energy companies, tender offerors, and securities investors) must and *routinely do* make reasonable determinations of such future events in order to value the properties involved.

The uncontested evidence in the record is that this is the practice generally used in the oil and gas industry for valuation of reserves and that the First Boston and Strong Reports were prepared in a manner consistent with the industry's practice.

President Hoopman of Marathon, for example, testified that "when oil properties change hands, in most instances it's done on a calculation of discounted cash flow. . . ." U.S. Steel's Vice President Corry testified that "a lot of securities analysts would always put out security analysts' reports, and they would usually go through the same exercise and say the present value of this company's reserves, X and Y."

Thus, the uncontradicted evidence was that, in fact, the oil and gas industry and its investors do consider the valua-

tion studies like the First Boston and Strong Reports to be important. The valuation appraisals in fact assume "actual significance to the reasonable investor." 426 U.S. at 450. And the disclosure of the appraisals "would have been viewed as having significantly altered the 'total mix' of information made available." *Id.*

Appropriate application of the materiality standard enunciated in *TSC* is reflected in *SEC v. MacDonald*, 699 F.2d 47 (1st Cir. 1983). There the First Circuit recently explained:

> "[I]nvestors regularly deal in probabilities and expectations, rather than certainties. The materiality of facts regarding a contingent future event is simply a function of the anticipated magnitude of the event if it occurs, discounted by the probability of its occurring. *See, SEC v. Texas Gulf Sulphur Co.*, 2 Cir., 1968, 401 F.2d 833, 849, *cert. denied*, 394 U.S. 976. . . . A 'reasonable, if speculative, investor' would consider information indicating even the possible occurrence of an event of magnitude to be important. *Id.* at 849-50. Here, the future event was sufficiently large to remain material even discounting for whatever uncertainty may be thought to have existed."

699 F.2d at 50. This approach properly takes into account the nature of the industry involved and its practices, as well as the actual informational needs of investors in that industry.

Yet the court below imposed a standard that is inconsistent both with *TSC*'s holding of what is "material" and with the general purpose of the federal securities laws to require *full disclosure* of important information. The Sixth Circuit stated in *Starkman* that its cases "firmly establish the rule that soft information such as asset appraisals and projections must be disclosed only if the reported values are *virtually as certain as hard facts*." 772 F.2d at 241; A44 (italics supplied). Thus, no matter how reasonable investors may be in considering these asset valuations significant, which is the standard enunciated in *TSC*, the Sixth Circuit would preclude their disclosure.[8]

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8. Viewed another way, in order to harmonize its standard with *TSC*, the court below would have to conclude that all investors who consider these asset valuations significant must be "unreasonable" as a matter of law.

The direct effect of the holding below, therefore, is to withhold from investors the most pertinent information available concerning the principal assets of oil and gas companies: their reserves. This directly conflicts with this Court's clear holding in *TSC*.

POINT III

The Inconsistency of the Decision below with this Court's Holding in *TSC Industries Inc. v. Northway, Inc.* and the Conflict between the Decision below and the Third Circuit's Opinion in *Flynn v. Bass Brothers Enterprises, Inc.* are the Direct Result of the Sixth Circuit's Misunderstanding of SEC Policy and Practice and of Certain Uncontested Facts in this Record.

The Sixth Circuit, in reviewing the pronouncements of the SEC, concluded in *Starkman* that the reports at issue here "contain estimates of probable and possible reserves, and the disclosure of this information was *actually prohibited* at the time of Steel's tender offer. . . ." 772 F.2d at 240; A43 (italics supplied). Yet, in *Flynn*, the court concluded that, "[A]t the time Bass Brothers was making its tender offer [in 1976], although courts did not generally require the disclosure of asset valuations, such disclosure was not prohibited." 744 F.2d at 986. The Sixth Circuit's view also is directly contrary to an official Release published by the SEC prior to the U.S. Steel tender offer. Moreover, the court's misstatement of SEC policy[9] is compounded by the court's clear factual misunderstanding as to the nature of the Reports, particularly the First Boston Report.

SEC policy and practice concerning the disclosure of asset valuations and projections have undergone a steady evolution toward more and more disclosure of so-called "soft" information over the past 9 years. The court in *Flynn* reviewed this progression in detail:

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9. Petitioners respectfully suggest that the Court may find it of assistance to request of the SEC an expression of its views on this subject.

"With respect to disclosure of projections of future earnings, the SEC in 1976 deleted future earnings from the list of examples of potentially misleading disclosures in the note which follows rule 14a-9.[15]

"More importantly, in 1978 the SEC issued a safe harbor rule for 'forward-looking' statements, such as future earnings, made in good faith. 17 C.F.R. §230.175 (1983). And with respect to asset valuations, the SEC in 1980 authorized disclosure of good faith appraisals made on a reasonable basis in proxy contests in which a principal issue is the liquidation of all or a portion of a target company's assets. See SEC Release No. 34-16833, Fed.Sec.L.Rep. (CCH) ¶24,117 (May 23, 1980), codified at 17 C.F.R. §241.16833 (1983). While SEC policy has not yet explicitly approved the disclosure of appraisal values when the target is to continue as a going concern rather than being liquidated, recent SEC promulgations herald a new view, more favorably disposed towards disclosure.

"15. *See* Securities Act Release No. 5699, Notice of Adoption of an Amendment to Rule 14a-9, etc. [1975-1976 Transfer Binder] CCH Fed.Sec.L.Rep. ¶80,461 (1976)."

744 F.2d at 986-987. The *Flynn* court also explained that "the initial prohibition of soft information [resulted from] the fear that potential *purchasers* of securities would be misled by overly optimistic claims by management. . . . An unintended by-product of such concern, however, was to keep valuable information from those shareholders who had to decide, within the context of a tender offer or merger, whether or not to *sell* their securities."[10] 744 F.2d at 987 (italics in original).

In this context of increasing allowance of disclosure of asset valuations and projections, the SEC issued Release No.

10. The irony of the illogical ruling below is that Marathon shareholders were given the soft information at the time of the merger, when they were purchasers of U.S. Steel's debenture, but not at the time of the tender offer, when they sold half their Marathon stock for cash.

33-6332,[11] dated August 6, 1981. In this Release, the Commission proposed revision to its Regulation S-K pertaining to disclosures to be made in documents filed with the SEC. The Release described "the present Commission practice" concerning the disclosure of probable and possible reserves.[12] Release No. 33-6332, p.29; A65. Specifically, the SEC stated that it was, in August 1981, "consistent with staff practices" to permit disclosure, with the staff's prior approval, of "reserves other than proven oil and gas reserves . . . [where it is shown] that the deletion of such reserve disclosure would render the document materially misleading. . . ." *Id.*

From this authoritative Release, it is clear that the Sixth Circuit made a significant, indeed critical, error in its understanding of SEC policy and practice. The *Starkman* opinion does not even mention Release No. 33-6332. In this case,[13] Petitioners cited and discussed that Release in their briefs to the Sixth Circuit, yet the court below merely referred to its discussion of materiality decided in *Starkman*. 772 F.2d at 252-253; A14-A15. The court did not discuss Release No. 33-6332.

The importance of the SEC's actual practice and policy at the time of the U.S. Steel tender offer cannot be understated. The underlying purpose of the federal securities laws is full disclosure of all material facts. *Schreiber v. Burlington Northern, Inc.*, 53 U.S.L.W. at 4655; *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151 (1972); *SEC v. Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963). Consistent with the Court's definition of material information in *TSC*, the Commission has recognized—and had recognized at the time

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11. The Release also bears nos. 34-18008, 35-22150, and 39-647. It is reproduced in Fed.Sec.L.Rep. (CCH) No. 926, Part II (Aug. 12, 1981). The discussion of "Item 102, Description of Property," contained in pages 28-30 of the Release, is set forth as Appendix D hereto.

12. The Sixth Circuit nowhere explained why defendants were not obligated to disclose the asset valuations at least to the extent of Marathon's *proven* reserves.

13. The same panel of three judges decided both cases on the same day, and both opinions were authored by the same Circuit Judge.

of the tender offer—that disclosure of estimates of reserves other than proved reserves can be made if required in order to prevent a filing from otherwise being materially misleading.[14]

Thus, in September 1982, the SEC staff was able to state in a Staff Accounting Bulletin that it had "for the past several years" actually suggested a form of disclosure of reserves other than proved reserves. Staff Accounting Bulletin No. 47, September 16, 1982, reproduced in 6 Fed.Sec.L.Rep. (CCH) ¶74,211, p.63,944. Indeed, the Bulletin expressly responds to the question, "what types of disclosures *will be permitted* by registrants who wish to indicate that some of their properties have value other than that attributable to proved reserves?" *Id.* (italics supplied). The "Interpretive Response" was:

> "The Office of Engineering has, for the past several years, suggested to registrants the following form of disclosure for undeveloped lease acreage:
>
> > 'In addition to proved reserves, the estimated (or appraised) value of leases or parts of leases to which proved reserves cannot be attributable is $xxx.'"

Id. This Bulletin confirms that, at the time of the tender offer, the Commission was not only not prohibiting the disclosure of probable and possible reserves, but in fact was even suggesting a form by which that disclosure could be made.

In addition to failing to take account of SEC policy and practice, the Sixth Circuit employed faulty logic. Apparently, the court reached the conclusion that the disclosure of probable and possible reserves was prohibited merely because the disclosure was not expressly required. This reasoning is clear from the language in *Starkman* that the disclosure was "only *permitted* since" the tender offer. 772 F.2d at 240; A43 (italics original).

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14. Indeed, both Rule 10b-5 and Regulation S-K set forth this general over-weaning principle. Where additional disclosure beyond the required minimum is necessary to prevent a document from being deceptive, that disclosure must also be made. *E.g., Zell v. Intercapital Income Securities, Inc.*, 675 F.2d 1041, 1044 (9th Cir. 1982); *Maldonado v. Flynn*, 597 F.2d 789, 796 n.6 (2d Cir. 1979).

The defect in this reasoning is plain: the Commission frequently will insist upon disclosure to prevent a filed document from being misleading even though the disclosure is not required in every case. As quoted above, the *Flynn* court recognized that such disclosure, although not generally required, "was not prohibited." 744 F.2d at 986. U.S. Steel itself acknowledged this in its comment to the SEC two weeks before the tender offer. There U.S. Steel stated in connection with Release No. 33-6332:

> "As the Commission is well aware, the non-disclosure of what were then only inferred reserves was the basis of the *Texas Gulf Sulphur* case."[15]

Letter, U.S. Steel to the SEC, October 30, 1981, Plaintiffs' Trial Exhibit 1110.

However, the SEC at the time of the U.S. Steel tender offer clearly *did* require the disclosure in documents filed with the Commission of probable and possible oil and gas reserves. SEC Rule 13e-3, 17 CFR §240.13e-3, and Schedule 13E-3, 17 CFR §240.13e-100, together command disclosure of any appraisal received from an outside party, which appraisal is materially related to a going-private transaction. Schedule 13E-3, Item 9. The Rule also requires disclosure of projections of revenues. Schedule 13E-3, Item 10. It was for this reason that the merger proxy statement and prospectus filed jointly by U.S. Steel and Marathon after the tender offer in fact finally disclosed the First Boston and Strong Reports. Thus, it is clear that, in the words of Section 13(e)(1) of the Securities Exchange Act of 1934, 15 U.S.C. §78m(e)(1), "the Commission deems [these appraisals and projections] to be material to a determination whether [the Marathon stock] should be sold."

Further, the Sixth Circuit's decision is premised upon a materially inaccurate characterization of uncontested facts. Of primary importance is the court's repeated misstatement

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15. *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied sub nom. Coates v. SEC*, 394 U.S. 976 (1969).

that the First Boston Report contained estimates of possible and potential reserves and that the estimates of those reserves and of Marathon's probable reserves were "a major component" of the Report.[16] 772 F.2d at 241; A43. In fact, contrary to the Sixth Circuit's understanding of the First Boston Report, that document did *not* include any appraisal of possible reserves or potential reserves at all. Further, the valuation of probable reserves was at most 12% of the proved reserves.[17] The Sixth Circuit nowhere explained why at least the proved reserves component of Marathon's assets, which equalled approximately 89% of the valuation of the reserves, should not have been disclosed.

Petitioners respectfully submit that, should this Court grant the instant Petition, the Court will conclude that the court below misunderstood SEC policy and practice and misapprehended the uncontested evidence concerning the nature of the Reports at issue. This, of course, is in addition to the erroneous standard applied below under this Court's decision in *TSC Industries, Inc. v. Northway, Inc.* and the conflict between the decision below and the correct application of *TSC* by the Third Circuit in *Flynn v. Bass Brothers Enterprises, Inc.*

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16. Another example of this clear miscomprehension of the report is: "The . . . First Boston report[] . . . contain[s] estimates of . . . possible reserves" (772 F.2d at 240; A43).

17. The probable reserves were calculated as 20% of the proved reserves and then discounted by 40%. Thus, the probable reserves were merely 60% of 20% (or 12%) of the proved reserves.

CONCLUSION

For all the foregoing reasons, Petitioners respectfully pray the Court grant a writ of certiorari to review the opinion and judgment of the United States Court of Appeals for the Sixth Circuit.

Respectfully submitted,

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December 12, 1985

CERTIFICATE OF SERVICE

I, David H. Weinstein, hereby certify that I am a member of the Bar of the Court, that I am one of the attorneys for petitioners on the foregoing Petition, and that three copies of the foregoing Petition were served on counsel for each respondent by United States mail this date by deposit of same in a United States post office or mail box, first class postage prepaid, addressed to counsel of record at their respective office addresses.

DATED: December 12, 1985 DAVID H. WEINSTEIN

Appendix A

No. 83-3598.

UNITED STATES COURT OF APPEALS, SIXTH CIRCUIT.

Argued Jan. 22, 1985.

Decided Sept. 13, 1985.

Irving and Charlotte RADOL, A. James Ibold, Dwight C. Baum, the Crossett Charitable Foundation, Reuben B. Fishbein, Trustee for Teri Fishbein Hecht, Beneficiary, and Robert C. Utley, on Behalf of Themselves and All Others Similarly Situated, Plaintiffs-Appellants,

v.

W. Bruce THOMAS, William R. Roesch, David M. Roderick, United States Steel Corporation, USS Inc., USS Holdings Company, USS Merger Sub, Inc., Goldman, Sachs & Co., Marathon Oil Company, Harold D. Hoopman, Charles H. Barre, Elmer H. Graham, W.E. Swales, Jack H. Herring, Victor G. Beghini, Neil A. Armstrong, James A.D. Geier, J.C. Haley, J.N. Land, Jr., Raymond C. Tower, Robert G. Wingerter, and the First Boston Corporation, Defendants-Appellees.

Jacob K. Stein [Lead Counsel], Paxton & Seasongood, Cincinnati, Ohio, Melvyn I. Weiss, argued, Milberg, Weiss, Bershad & Specthrie, New York City, Stanley R. Wolfe, Berger & Montague, P.C., Stewart Savett, Kohn, Savett, Marion & Graf, P.C., Philadelphia, Pa., for plaintiffs-appellants.

Murray Monroe, Cincinnati, Ohio, John L. Strauch [Marathon Oil], argued, Robert R. Weller, John M. Newman, Jr., Cleveland, Ohio, Richard S. Walinski, Toledo, Ohio, John W. Beatty, Cincinnati, Ohio, Richard J. Holwell [Lead Counsel], argued, Richard Reinthaler, New York City, William D. Ginn, Cleveland, Ohio, Henry T. Reath, Thomas Preston, Duane,

Morris & Heckscher, Philadelphia, Pa., David C. Greer, Dayton, Ohio, Michael P. Graney, Simpson, Thacher & Bartlett, Columbus, Ohio, James T. Griffin, Michael P. Mullen, William J. Raleigh, Chicago, Ill., Ronald S. Rolfe, Cravath, Swaine & Moore, New York City, N.Y., for defendants-appellees.

Before MERRITT and KENNEDY, Circuit Judges; and PECK, Senior Circuit Judge.

MERRITT, Circuit Judge.

This class action suit arises out of the fall, 1981 contest for control of Marathon Oil Company which ended in a two-stage merger of Marathon into United States Steel (Steel), one of the largest mergers in United States history. The first stage involved a tender offer by Steel for 51 per cent of Marathon's outstanding shares at $125 per share. The second stage was a "freezeout merger"—a merger in which the majority buys out the minority shareholders—with Marathon merged into Steel as a wholly owned subsidiary, and remaining Marathon shareholders receiving bonds worth approximately $76 per Marathon share. This suit is the consolidation of 13 separate actions challenging the two-step acquisition of Marathon by Steel as violative of the federal securities laws and state common law and fiduciary duty obligations. The three primary contentions underlying the various legal issues are that certain appraisals of Marathon's assets should have been disclosed to Marathon shareholders at the tender offer stage of the transaction, that the two-tier transaction with a second stage merger price lower than the front-end tender offer price was illegally coercive, and that Marathon's directors breached their fiduciary duty to the shareholders by structuring such a transaction in order to preserve their control over Marathon.

This action was heard before Judge Rubin in the Southern District of Ohio, and all issues were decided in favor of the defendants, some on summary judgment and others after trial before a jury. On appeal, the plaintiffs raise a large

number of essentially legal challenges to the proceedings in the District Court, but for the reasons set forth at length below, we reject these challenges and affirm the District Court's decision in all respects.

I. FACTUAL BACKGROUND

In October, 1981, Marathon was a widely held, publicly traded Ohio corporation with over 58 million shares held by over 35,000 stockholders. Marathon was a vertically integrated oil and gas company, conducting exploration, production, transportation, refining and marketing and research. From 1976 to 1980, Marathon's net revenues and profits advanced at average annual rates exceeding 15%, but the first half of 1981 brought lower worldwide demand for oil and a strengthened dollar, events causing a sharp reversal in Marathon's performance. Earnings per share plunged to $2.64 from $4.08 a year earlier, and during the June, 1981 quarter, Marathon's four U.S. refineries operated at only 58% of capacity. A. 2588, Def.Ex. 424.10.[1] The market price of a share of Marathon common stock, which had stood at $81 in November, 1980, fell to $45 in June, 1981. A. 2686, Def.Ex. 695.

Although Marathon's stock price had fallen during early 1981, the company held substantial long term oil and gas reserves, including the Yates Field in West Texas, one of the largest and most productive oil fields ever discovered, and along with a number of other oil companies, Marathon became a prime potential takeover target in the summer of 1981. In this threatening atmosphere, Marathon's top level management began preparations to defend against a hostile takeover bid. Harold Hoopman, Marathon's president and chief executive officer, instructed the company's vice presidents to compile a catalog of Marathon's assets. This document, referred to as the "Strong Report" or "internal asset evaluation," estimated the value of Marathon's transportation,

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1. Throughout this opinion, "A" refers to the appendix on this appeal, "Def. (Pl.) Ex." refers to defendants' (plaintiffs') exhibit below, and "T" refers to the trial transcript.

refining and marketing assets, its other equipment and structures, and the value of proven, probable and potential oil reserves as well as exploratory acreage. This report, discussed at greater length in *Starkman v. Marathon Oil Co.*, 772 F.2d 231, (6th Cir. 1985), estimated the present value of oil and gas properties based on highly speculative assumptions regarding the level of prices and costs expected to prevail as far as thirty to fifty years into the future, and was described by Hoopman and John Strong, his assistant who was responsible for combining materials received from the various divisions into the final report, as a "selling document" which placed optimistic values on Marathon's oil and gas reserves so as to attract the interest of prospective buyers and ensure that Marathon could either ward off a hostile takeover attempt or at the very least obtain the best offer available and avoid being captured at a bargain price.

The Strong Report valued Marathon's net assets at between $19 billion and $16 billion, a per share value of between $323 and $276. A similar report using identical methodology but based only on publicly available information (excluding, therefore, potential and unexplored acreage) was prepared in mid-July 1981 by the investment banking firm of First Boston, which had been hired by Marathon to assist in preparing for potential takeover bids. The First Boston Report was similarly described as a "presentation piece" to avoid a takeover or to maximize the price obtained in a takeover, and it placed Marathon's net asset value at between $188 and $225 per share.

Marathon's market value was far below these appraised values, however, and on October 29, 1981, Marathon closed at $63.75 per share. The next day, Mobil Oil Company announced its tender offer to purchase up to approximately 68% of outstanding Marathon common stock for $85 per share in cash. Mobil proposed to follow the tender offer with a going-private or freezeout merger in which the remaining shareholders of Marathon would receive sinking fund debentures worth approximately $85 per share.

On October 31, 1981, Marathon's board of directors met in a

day-long emergency session to consider Mobil's hostile tender offer. At this time, there were twelve members of Marathon's board, equally split between inside and outside directors. The inside directors were Hoopman and Marathon's five divisional vice presidents. The outside directors were N.A. Armstrong, former astronaut; J.A.D. Geier, the chairman of Cincinnati Milacron; J. Haley, vice president of Chase Manhattan Bank; R.G. Weingerter, chairman of LOF; R.C. Tower, president of FMC; and J.N. Land, a former investment banker then engaged in financial consulting. Haley was the only director absent from the October 30, 1981 meeting.

The meeting began with a presentation by inside and outside legal counsel explaining the possible adverse antitrust implications of the Mobil offer and reviewing the legal obligations of the board to act in the best interests of Marathon's shareholders. Representatives of First Boston then delivered a lengthy presentation in which they compared the premium over market price offered by Mobil and stated their opinion that this premium was at best modest compared with other recent oil company takeovers. First Boston presented the results of its asset valuation report, but cautioned that the values did not represent realistic market values, as evidenced by the large number of companies whose market value was far less than their appraised value, and also that liquidation value would be significantly less than appraised value because of the relative bargaining positions in a liquidation, which in any event was felt to be an unrealistic response to Mobil's tender offer because of the length of time required to secure shareholder approval of a liquidation. First Boston urged the board to take quick action to find an alternative merger partner in the time remaining for shareholders to withdraw their tenders to Mobil, because even with potential antitrust problems, First Boston thought Mobil's offer still capable of succeeding.

After this presentation by First Boston, John Strong, Hoopman's assistant, spoke briefly and handed out the executive summary to the Strong Report. He described the document as a catalog that would be used in trying to sell the

company to another bidder, and cautioned that there was very little correlation between the theoretical asset valuations and the market value of Marathon.

At the completion of these discussions, the outside directors met separately and unanimously determined to recommend that the board as a whole reject Mobil's offer, based on its potential illegality under the antitrust laws and the opinion of First Boston and the directors' own opinion that it was unfair to shareholders. The board as a whole then reconvened and unanimously agreed to recommend that shareholders reject Mobil's offer and authorized management to begin immediately the search for another potential bidder and also authorized counsel to file an antitrust suit seeking to enjoin Mobil from proceeding further with its bid.

On November 1, 1981, Marathon filed its antitrust suit against Mobil, *Marathon Oil Co. v. Mobil Corp.*, 530 F.Supp. 315 (N.D. Ohio 1981), and secured a temporary restraining order prohibiting Mobil from purchasing any additional Marathon shares. Marathon's board and senior management meanwhile speedily contacted all of the thirty to forty companies who were considered reasonable merger candidates, while simultaneously advising shareholders by letter to reject Mobil's bid as "grossly inadequate." Both the Strong and First Boston reports were presented to potential merger partners in an attempt to kindle interest in Marathon.

Representatives of Steel and Marathon first met on November 10, 1981, at which time Hoopman gave Steel president David Roderick a copy of the asset valuation reports. On November 12, board member Elmer Graham, Marathon's vice president for finance, delivered financial information, including five-year earnings and cash flow projections to Steel in Pittsburgh. Negotiations between Hoopman and Roderick ended on November 17 in an offer by Steel to purchase up to 30 million shares (about 51%) of Marathon stock for $125 per share in cash, to be followed by a merger proposal in which each remaining Marathon shareholder would receive one $100 face value, 12 year, 12½% guaranteed note per share of common stock.

On November 18, a formal meeting of Marathon's board was held to consider Steel's offer in light of competing, but more tentative, proposals from Allied Corporation and Gulf Oil Corporation. Allied's proposal was considered to be highly questionable, because it was premised upon Marathon's purchase of an Allied subsidiary at a greatly inflated price in order to give Allied the cash to bid $101-105 per share for a minority interest in Marathon. Gulf proposed to purchase 50% of the outstanding Marathon shares for $130-140 per share and then consummate a merger in which Marathon shareholders would receive securities worth $100-110 per share, but Marathon's counsel advised that a merger with Gulf would pose antitrust problems equal to if not more severe than those raised in Marathon's own antitrust suit against Mobil. First Boston estimated that since current market interest rates were then in the 18 to 20% range, the second stage notes offered in Steel's proposal would sell for approximately $86 per share, yielding an average price, with the first stage tender offer at $125 per share, of $106 per share. First Boston then compared the 76.6% premium over market offered by Steel with other recent takeover premiums, showing that the premium offered by Steel greatly exceeded the average premium in recent control transactions. First Boston recommended that the board accept Steel's bid.

Steel's offer was communicated by Roderick over a conference telephone call to the entire Marathon board, and was offered on a take-it-or-leave-it basis, to remain open for one day. After Roderick's call, the board discussed Steel's offer, and outside director Land asked if there were any severance agreements or "golden parachutes" granted to Marathon's senior management in a side agreement. Hoopman answered that Steel had agreed only to cash out Marathon employee stock options held by the officers and upper level management at the expected average price offered by Steel to other Marathon shareholders of $106 per share, and that Steel had requested that the present Marathon board be kept intact. After this brief discussion, the directors were polled indi-

vidually, and voted unanimously in favor of recommending that the shareholders accept Steel's offer.[2]

Steel mailed its tender offer on November 19, 1981, and simultaneously filed a Schedule 14D-1 with the SEC, as required by Rule 14d-3, 17 C.F.R. § 240.14d-3. Steel's tender offer specifically stated that the tender offer was the first step in "United States Steel's proposed acquisition of the entire equity interest" in Marathon, and described the terms of the second stage bond exchange. Def.Ex. 233, A. 2222, 2331-32. Hoopman sent a letter to Marathon's shareholders on November 19 in which he similarly described the two-tier transaction and recommended that shareholders accept Steel's tender offer. Def.Ex. 382, A. 2353. Marathon's Schedule 14D-9 attached to Hoopman's letter informed the shareholders of Gulf's proposal (describing Gulf anonymously as a "major oil company") and stated that this proposal had not been accepted because of anticipated antitrust problems. *Id.* Neither Steel's tender offer materials nor Hoopman's letter and attached Schedule 14D-9 revealed the existence of the Strong and First Boston reports and neither discussed Marathon's net appraised value, but Steel's tender offer did disclose that Steel had access to net income and cash flow projections for Marathon which were not publicly available, and those figures were set forth. Def.Ex. 233, A. 2228.

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2. The description of the October 31 and November 18 board meetings is drawn from Armstrong's testimony, T. 1811-1856, A. 758-800; Hoopman's testimony on cross, T. 830-36, A. 356-62; and the minutes of Marathon board meetings, Def.Ex.'s 218-220, A. 1941-69.

In the final agreement, Marathon also granted U.S. Steel an option to purchase up to 10,000 shares of Marathon common stock for $90 per share, and an option to purchase Marathon's interest in the Yates oil field for $2.8 billion if U.S. Steel's tender offer failed and another corporation succeeded in acquiring a majority interest in Marathon. On November 24, 1981, Mobil sued Marathon, U.S. Steel and directors of Marathon, seeking to enjoin the U.S. Steel tender offer. On December 23, 1981, this court invalidated both the stock and Yates Field options as "manipulative devices" under 14(e) of the 1934 Exchange Act, 15 U.S.C. § 78n(e), and ordered that the U.S. Steel tender offer be kept open for a reasonable time. On remand, the District Court set a withdrawal deadline for the U.S. Steel offer of midnight, January 6, 1982 (the original withdrawal date stated in the offer was December 17, 1981). *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

After Steel's tender offer was announced, the market price of Marathon stock rose, and fluctuated between $100 and $105 per share from November 19 until December 7. Def.Ex. 695, A. 2688-89. Mobil modified its offer in response to Steel's competing bid to provide for the purchase of 30 million shares at $126 per share, to be followed by a transaction in which the remaining shares would be exchanged for various securities to be valued at about $90 per share, and Mobil's offer remained open until enjoined on November 30 on the ground that it entailed probable antitrust violations. *Marathon Oil Co. v. Mobil Corp.*, 530 F.Supp. 315 (N.D. Ohio), *aff'd*, 669 F.2d 378 (6th Cir. 1981), *cert. denied*, 455 U.S. 982, 102 S.Ct. 1490, 71 L.Ed.2d 691 (1982). After this court invalidated both the stock and Yates Field options originally promised to Steel as manipulative devices under Section 14(e) of the Williams Act in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981), the withdrawal date on Steel's tender offer was set at January 6, 1982. Between the original withdrawal deadline of December 7 and January 6, 1982, Marathon stock traded at between $88 and $82 per share. Def.Ex. 695, A. 2688-89. By this latter date, a total of over 53 million shares, or 91.18% of the total outstanding had been tendered to Steel, and Steel purchased the promised 30 million shares on a pro rata basis on January 7.

On February 8, 1982, a proxy statement was sent to the remaining Marathon shareholders announcing a March 11, 1982 shareholder meeting at which the merger with Steel would be consummated if approved by two thirds of the Marathon stockholders, as required by Ohio law.[3] The proxy statement discussed the Strong and First Boston appraisals at

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3. Ohio Revised Code 1701.78(F) provides in pertinent part:

> The vote required to adopt an agreement of merger or consolidation at a meeting of the shareholders of a constituent domestic corporation is the affirmative vote of the holders of shares of that corporation entitling them to exercise at least two-thirds of the voting power of the corporation on such proposal or such different proportion as the articles may provide, but not less than a majority, and such affirmative vote of the holders of shares of any particular class as is required by the articles of that corporation.

some length, as is required in freezeout mergers by Rule 13e-3, 17 C.F.R. § 240-13e-3, warning, however, that the First Boston Report "should not be regarded as an independent evaluation or appraisal of Marathon's assets," and that the two reports were not "viewed by Marathon's Board of Directors as being reflective of . . . per share values that could realistically be expected to be received by Marathon or its shareholders in a negotiated sale of the Company as a going concern or through liquidation of the Company's assets." Def.Ex. 756, A. 2707-08.

On March 11, 1982, the special shareholder meeting was held, and the shareholders approved the merger with approximately 55% of the non-Steel Marathon shareholders voting for the merger, 20% voting against the merger, and 25% abstaining or not voting. A. 3525, Doc. 147. Marathon stock had traded at between $76 and $73 from the January 6 purchase date to the date of the shareholder meeting, indicating that the market eventually valued the bonds received in the merger at roughly $10 per share less than was forecast by First Boston.

II. SUMMARY OF PROCEEDINGS BELOW

The present class action suit represents the consolidation of thirteen separate actions by former Marathon shareholders asserting claims against Marathon, Steel, their directors (as of November, 1981) and investment bankers. The plaintiff class consists of two subclasses: Marathon shareholders who owned stock on November 19, 1981 and did not tender to Steel; and those who did tender to Steel. The plaintiffs presented claims under the federal securities laws and alleged state common law fraud and breach of fiduciary duty. Of these various claims, there are five substantive issues involved in this appeal, and we briefly summarize the treatment of these issues below before discussing our disposition of each in more detail.

On February 2, 1983, Judge Rubin granted defendants' motion for summary judgment on all of the plaintiffs' federal

securities law claims except the claim that the failure of the Marathon and Steel defendants to disclose the Strong and First Boston Reports in the tender offer materials violated Section 10(b) of the Securities and Exchange Act of 1934 (the Exchange Act), 15 U.S.C. § 78j(b), SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, and Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e).[4] Plaintiffs claimed that the failure to disclose these documents in the tender offer materials constituted the omission of material facts necessary to make the other statements

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4. Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e) provides, in pertinent part:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commece, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

made not misleading. In *Radol v. Thomas*, 556 F.Supp. 586, 593-94 (S.D. Ohio 1983), the District Court ruled that under the definition of materiality set forth in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), the issue of whether the Strong and First Boston asset appraisals were material facts was a question "best left to a jury." In answer to questions 1 and 2 of the special interrogatory, the jury found unanimously that the omission of these reports from the tender offer materials distributed on November 19, 1981, did not violate the federal securities laws. T. 2667, A. 1053.

The District Court entered summary judgment for the defendants on plaintiffs' claim that the tender offer materials constituted proxy solicitation because they represented the tender offer and second stage merger as a unitary transaction and violated Section 14(a) of the Exchange Act because they failed to comply with the proxy disclosure rules.[5] Judge Rubin reaffirmed the view (as expressed in his decision denying plaintiffs' motion for a preliminary injunction) that "a tender offer and merger are distinct acts with separate consequences toward which the securities laws and SEC Rules are directed in their regulatory schemes," and that references to the second stage merger in the tender offer materials were made in compliance with SEC rules governing tender offers and "were not the equivalent of solicitations for the merger which would call forth application of the full panoply of the proxy rules." 556 F.Supp. at 591 (quoting *Radol v. Thomas*, 534 F.Supp. 1302, 1314 (S.D. Ohio 1982)).

On the final federal securities claim at issue on this appeal, the District Court ruled that the two-tier merger of

5. Section 14(a) provides:

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title.

Marathon and Steel did not constitute market "manipulation" in violation of Section 10(b) of the Exchange Act or Section 14(e) of the Williams Act. 556 F.Supp. at 589-90. Judge Rubin observed that although the disparity between the front-end tender offer price offered by Steel and the back-end merger price did place pressure on Marathon shareholders to accept the tender offer, all tender offers are to some extent coercive, but the two-tier tender offer here did not "circumvent the natural forces of market demand" and did not discourage competing offerors and was therefore not "manipulative" under our interpretation of the term in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981).

The District Court refused to grant summary judgment for the defendants on plaintiffs' state law claim that Marathon's board violated their fiduciary duty to Marathon's shareholders by structuring a coercive two-stage transaction and consummating the merger at an unfair price, by failing to disclose the Strong and First Boston reports and other material information, and by cashing out their stock options at terms that were unavailable to other Marathon shareholders. A. 3316-18, 3321-22. The jury subsequently unanimously found that Marathon's directors had not breached their fiduciary duties to Marathon shareholders. A. 2667.

The District Court, however, entered summary judgment for Steel on plaintiffs' fiduciary duty claims, finding that Steel's involvement as a fiduciary was only as a majority shareholder of Marathon after the tender offer and only with respect to consummation of the second stage merger. Judge Rubin held that under Ohio law, a dissenting minority shareholder's sole remedy to redress his dissatisfaction with a freezeout merger is the statutory appraisal action provided by O.R.C. § 1701.85(A), provided that the merger is authorized by statute. A. 3318.

III. DISCUSSION: FEDERAL SECURITIES ISSUES

A. Duty to Disclose the Strong and First Boston Appraisals

Rule 13e-3(e), 17 C.F.R. § 240.13e-3(e), requires the dis-

closure of certain information set forth in Schedule 13E-3, 17 C.F.R. § 240.13e-100, in freezeout merger proxy statements. Item 9 of Schedule 13E-3 requires that a summary of any asset appraisal prepared in connection with such a merger must be furnished, and the summary must describe the methods, results and underlying assumptions of the appraisal. Steel complied with this rule by describing the Strong and First Boston reports in the second stage merger proxy statement. Plaintiffs contend, however, that such disclosure should also have been made in the tender offer materials distributed to shareholders by Marathon and Steel, and that the failure to disclose these reports violated Section 10(b) of the Exchange Act, Rule 10b-5, and Section 14(e) of the Williams Act because it constituted an omission of material facts necessary to make not misleading other affirmative statements made in the tender offer materials.

On appeal, plaintiffs particularly challenge the trial court's jury instructions on materiality and the duty to disclose these reports. The disputed instructions state:

> An omitted fact is material if there is a substantial likelihood that a reasonable person would consider it important in deciding whether to tender his stock.
>
> Only disclosure of existing material facts is required. Economic forecasts are not.
>
> A failure to make known a projection of future earnings is not a violation of the Federal Securities law.

T. 2647-48, A. 1045-46.

In *Starkman v. Marathon Oil Co.*, 772 F.2d 231, (6th Cir. 1985), we have reaffirmed our adherence to the basic rule established by our prior decisions that tender offer materials must disclose soft information, such as these asset appraisals based upon predictions regarding future economic and corporate events, only if the predictions underlying the appraisal are substantially certain to hold. The Supreme Court's test for materiality as set forth in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976), is whether there is a "substantial likelihood that, un-

der all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." The District Court's instructions to the jury accurately stated this general test for materiality and the specific rule in this circuit governing the duty to disclose asset appraisals, and we have, in any event, held in *Starkman* that there was no duty to disclose the asset appraisals at issue here.

Indeed, if there was an error below on this issue, it was in allowing it to reach the jury. There is no other reported decision sending the materiality of an asset appraisal to the jury; every such decision involving an asset appraisal has held that there was no duty to disclose the appraisal.[6] Judge Rubin ruled that the Strong and First Boston reports were not immaterial as a matter of law because "[i]t is *conceivable* that a 'reasonable shareholder' would have accorded the valuations 'actual significance' in his deliberations, even if disclosure would not have altered his decision." *Radol v. Thomas*, 556 F.Supp. 586, 594 (S.D. Ohio 1983) (emphasis supplied). But the Supreme Court in *TSC Industries v. Northway*, 426 U.S. at 445-48, 96 S.Ct. at 2130-32, specifically reversed the court of appeals' definition in that case of material facts as all those which a reasonable shareholder *might* consider important, a definition which is essentially identical to Judge Rubin's ruling that the Strong and First Boston reports could be found to be material because a reasonable shareholder *conceivably* could consider them important. The purpose of the more stringent "substantial likelihood" test for materiality is to lessen the uncertainty facing corporate officials in determining what must be disclosed while preserving shareholders' access to all truly factual information. Even with the correct instructions on materiality, sending the issue to the jury on the basis of an incorrect application of the test for materiality introduces great uncertainty regarding a particular jury's view

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6. See the discussion in *Starkman v. Marathon Oil Co.*, 772 F.2d 231, (6th Cir. 1985), and the compilation of cases in *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978, 986, 988 (3d Cir. 1984).

of "substantial likelihood," and under our decisions, the District Court should have ruled that the reports were not material and removed the issue from the jury.

B. Failure to Comply with the Proxy Rules

Plaintiffs claim that since the tender offer and the merger were viewed and represented by Steel and Marathon as a "unitary transaction," Marathon and Steel's tender offer materials constituted solicitations of shareholder consent to the proposed merger and should have contained all the information required to be included in a proxy statement under Section 14(a) of the Exchange Act. Relying on recent law review commentary,[7] plaintiffs argue that the two-tier tender offer put the typical Marathon shareholder in a position where he had to assume that if he tendered, he would virtually assure Steel's ability to consummate the merger, and that shareholders thus should have received all the information needed to evaluate the merger prior to the deadline tendering. The only judicial authority adduced in support of the plaintiffs' position is Judge Learned Hand's ruling in *SEC v. Okin*, 132 F.2d 784, 786 (2d Cir. 1943), that "writings which are part of a continuous plan ending in solicitation and which prepare the way for its success" are subject to the SEC's power to regulate proxy solicitations.

In rejecting this claim on the defendants' summary judgment motion, Judge Rubin correctly ruled that "a tender offer and subsequent merger are distinct acts with separate concerns toward which the securities laws and SEC rules are directed in their regulatory schemes," and that it was "entirely appropriate to consider each step in such a transaction separately." *Radol v. Thomas*, 556 F.Supp. 586, 591 (S.D.Ohio 1983). Steel complied with Rule 14d-3, 17 C.F.R. § 240.14d-3,

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7. Plaintiffs rely on Brudney and Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 Harv.L.Rev. 297, 330-40 (1974), and Brudney and Chirelstein, *A Restatement of Corporate Freezeouts*, 87 Yale L.J. 1354, 1361-62 (1978), where the authors argue that two-tier tender offers involving a second stage merger at a lower price than the front end tender offer are inherently coercive and should be prohibited.

by filing a Schedule 14D-1 with the Commission which disclosed the basic terms of the proposed merger with Marathon, as required by Item 5(a) of 17 C.F.R. § 240.14d-100. As the target, Marathon complied with Rule 14e-2, 17 C.F.R. § 240.14e-2, by sending a letter to its shareholders recommending acceptance of Steel's offer and describing the two-stage plan, and Marathon also complied with Rule 14d-9, 17 C.F.R. § 240.14d-9 by filing a Schedule 14D-9 with the Commission which described the basic terms of the merger. Both Steel and Marathon therefore complied with the specific disclosure requirements which apply to tender offers.

Requiring compliance with the proxy rules, in particular Rule 14a-9, 17 C.F.R. § 240.14a-9, or the specific freezeout merger proxy disclosure requirements in Rule 13e-3, 17 C.F.R. § 240.13e-3, in the tender offer stage of a two-tier transaction of this sort would be unfair because it would subject the tender offeror and target to the risk of liability for violating Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e, by making an "offer to sell" securities prior to filing a registration statement for the securities.[8] In Securities Act Release No. 33-5927, *reprinted in* 3 Fed.Sec.L.Rep. (CCH) ¶ 24,284H (April 24, 1978), the Commission stated that the Section 5 "jumping the gun" prohibition would not apply to disclosure of a proposed second stage merger in tender offer materials as required by Schedule 14D-1, because to rule that such disclosure constituted an offer to sell would not further the policies of the 1933 Act and would be inconsistent with the Williams Act policy of requiring such information in order to provide full disclosure to investors confronted with an investment decision in the context of a tender offer. However, the Commission also warned that disclosure at the tender offer stage should not go beyond that specifically required by the Williams Act and the tender offer rules, and that "statements which are not required by the Williams Act may constitute an 'offer to sell' the securities to be exchanged in the

8. The securities involved here are the bonds to be exchanged for remaining Marathon shares in the second stage merger.

subsequent merger and, in the absence of a registration statement filed with the Commission at the commencement of the tender offer, may constitute a violation of Section 5 of the 1933 Act." 3 Fed.Sec.L.Rep. at 17,754. The plaintiffs' proposed extension of the comprehensive proxy statement disclosure requirements to the tender offer stage of a two-tier transaction thus risks placing the board in a completely untenable position in which liability attaches under the proxy rules for too little disclosure and under the 1933 Act for too much disclosure, a result we are unwilling to endorse. *Accord Sheinberg v. Fluor Corp.*, 514 F.Supp. 133, 137 (S.D. N.Y.1981); *American General Corp. v. NLT Corp.*, [1982 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 98,808, at 94,142 (S.D.Texas July 1, 1982).

In addition, unlike *SEC v. Okin*, 132 F.2d at 786, where Judge Hand found that the Commission "would be powerless to protect shareholders" from misleading letters concerning an ongoing proxy solicitation sent in preparation for a soon-to-follow competing solicitation unless the letters were themselves held to be proxy solicitations, the Commission has set forth disclosure requirements for tender offers, and there are sound policy reasons for treating tender offers differently, with respect to the volume and content of required disclosure, than proxy statements.

Contrary to the plaintiffs' assumption, an individual shareholder does not assure the success of the second stage merger by choosing to tender in the first stage. Rather, the merger occurs only if the tender offer succeeds, and the success of the tender offer is determined by shareholders' collective valuation of the premium offered in relation to other competing offers (here, Mobil's outstanding tender offer). In the tender offer context, the market plays an important role in providing shareholders with information regarding the value of the target firm, and target management has an incentive to broker the best deal for shareholders and provide favorable, optimistic information to prospective bidders—precisely the kind of information the plaintiffs say was contained in the Strong and First Boston reports and precisely that which

majority shareholders have an incentive to keep from the minority in an unfair freeze-out merger. The more extensive legal disclosure requirements which apply to freeze-out merger proxy statements are therefore justified by the fact that the law has given the majority the power to foreclose the ownership rights of the minority and has thereby eliminated the market as a correcting mechanism, leaving minority shareholders with only the option of dissent and appraisal, an option which cannot rationally be exercised unless the majority is compelled to make full disclosure regarding appraisals, earnings projections and other information that sheds light on the value of the firm. *Cf.* Toms, *Compensating Shareholders Frozen Out in Two-Step Mergers*, 78 Colum.L.Rev. 548, 554-60 (1978) (observing how the negotiating position of management in a unitary merger differs fundamentally from that of the corporation's individual shareholder in a tender offer).

For these reasons, neither Steel nor Marathon had a duty to comply with the proxy rules in their tender offer statements.

C. The Two-Tier Tender Offer as Manipulation Under the Federal Securities Laws

In alleging that the two-tier, front-end-loaded acquisition of Marathon by Steel was a coercive and manipulative device, in violation of Section 14(e) of the Williams Act, Section 10(b) of the Exchange Act, and Rule 10b-5, plaintiffs have directly attacked the structure of this transaction as coercive, and have neither alleged below nor argued in this appeal that the two-tier transaction was not fully disclosed in Steel and Marathon's tender offer materials or that shareholders were in any manner deceived as to the nature of the transaction. In *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 477-79, 97 S.Ct. 1292, 1302-04, 51 L.Ed.2d 480 (1977), the Supreme Court held that allegations of deception or nondisclosure were essential to state a cause of action under Section 10(b). Based in large part on the interpretation of "manipulative" in *Santa Fe Industries*, and also on its reading of the legislative history of

the Williams Act, the Court recently ruled in *Schreiber v. Burlington Northern, Inc.*, ____ U.S. ____, 105 S.Ct. 2458, 2465, 86 L.Ed.2d 1 (1985), that without misrepresentation or nondisclosure, Section 14(e) of the Williams Act has not been violated, thereby rejecting this court's previous analysis in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (1981). Since the plaintiffs have failed to allege nondisclosure or misrepresentation of the two-tier transaction, but have instead attacked its structure, they have failed to state a claim under either Section 10(b) (and Rule 10b-5) or Section 14(e) and we affirm the District Court's entry of summary judgment for the defendants on this issue.

IV. STATE LAW ISSUES

A. Breach of Fiduciary Duty by Marathon's Directors

Plaintiffs initially argue that the District Court erroneously granted summary judgment on their claim that in structuring the coercive two-tier acquisition—including the intentional establishment of an unfairly low second stage price—Marathon's directors breached their fiduciary duty to the Marathon shareholders. The record, however, reveals otherwise. Judge Rubin specifically charged the jury that plaintiffs' claims included breach of fiduciary duty "by entering into an acquisition of Marathon by U.S. Steel on terms which were unfair to the shareholders of Marathon, and in particular to those shareholders who did not tender their shares to U.S. Steel." T. 2648, A. 1046. Moreover, the court's opinion denying the Marathon defendants' motion for summary judgment on the breach of fiduciary duty claim repeatedly characterizes that claim as revolving around "the Marathon directors' negotiation and approval of the structure and details of the two-step transaction . . . a transaction which was, allegedly, inherently unfair." A. 3321-22.

Having allowed the issue to reach the jury, Judge Rubin gave the following charge on breach of fiduciary duty:

> I do instruct you that officers and directors of a

corporation occupy a fiduciary relationship to the corporation and to its shareholders.

A fiduciary must exercise the utmost good faith, and he must give undivided loyalty. He must be scrupulously honest.

The exercise of the care, skill and diligence of a man of ordinary prudence dealing with his own property as a general rule fulfills the duty of a fiduciary.

In dealing with shareholders, a corporate officer or director must disclose to them all material facts.

A fiduciary, however, is not a guarantor or insurer. He is not liable for mistakes in judgment made in good faith.

The fiduciary duty is not breached unless the directors committed fraud, or intentionally acted contrary to the best interest of the corporation and the shareholders.

T. 2649-50, A. 1047-48.

On appeal, plaintiffs argue that the District Court erred in instructing the jury that Marathon's directors violated their fiduciary duty to the shareholders only if they committed fraud or intentionally acted contrary to the best interest of the shareholders. Plaintiffs contend that the directors were not entitled to this instruction because they were under a conflict of interest due to Steel's assurance that the present board would be continued intact and Steel's agreement to cash out stock options held by upper-level management at the expected average price in the two-tier deal.

We must look to Ohio for the substantive law on this question, and in Ohio as in every other state, the long established principle is that directors of a corporation have an obligation to the corporation which is in the nature of that of a fiduciary. *Ohio Drill & Tool Co. v. Johnson*, 625 F.2d 738, 742 (6th Cir. 1980); *Nienaber v. Katz*, 69 Ohio App. 153, 43 N.E.2d 322 (1942); 12 Ohio Jur.3d § 420, at 70-72 (1979). A director's obligation to the corporation includes two separate duties: the duty of loyalty and the duty of care. *See* ALI, Principles of Corporate Governance: Analysis and Recommendations, In-

troductory Note, Part IV, at 4 (Tent.Draft No. 4, April 12, 1985) (quoting *The Corporate Director's Guidebook*, 33 Bus.Law. 1591, 1599-1600 (1978) on the distinction between the duty of loyalty and the duty of care). The Ohio formulation of these duties was codified in 1984 in O.R.C. § 1701.59(B), and under the duty of loyalty, a "director shall perform his duties as a director . . . in good faith, in a manner he reasonably believes to be in the best interests of the corporation," while under the duty of care, a director must perform his duties "with the care that an ordinary prudent person in a like position would use under similar circumstances."

Moreover, in evaluating a director's compliance with the duty of care, Ohio courts adhere to the "business judgment rule," and will not inquire into the wisdom of actions taken by the directors in the absence of fraud, bad faith or abuse of discretion. 12 Ohio Jur.3d § 415, at 63-64 (1979); *Ohio National Life Insurance Co. v. Struble*, 82 Ohio App. 480, 485, 81 N.E.2d 622, 625, *appeal dismissed*, 150 Ohio St. 409, 82 N.E.2d 856 (1948). See also O.R.C. § 1701.59(C), which states that "a person who, as a director of a corporation, performs his duties in accordance with division (B) of this section (discussed above) shall have no liability because he is or has been a director of the corporation." The business judgment rule recognizes that many important corporate decisions are made under conditions of uncertainty, and it prevents courts from imposing liability on the basis of ex post judicial hindsight and lowers the volume of costly litigation challenging directorial actions. *See generally* 3A W. Fletcher, *Cyclopedia of the Law of Private Corporations § 1039, at 37-38 (1975 ed.)*.

Plaintiffs contend, however, that the trial court's instructions were erroneous because they failed to state the proposition established by *Ohio Drill & Tool Co. v. Johnson*, 625 F.2d 738, 742 (6th Cir. 1980), and *Seagrave v. Mount*, 212 F.2d 389, 397 (6th Cir. 1954), that good faith and full disclosure to shareholders do not insulate a director from liability if he has placed himself in a position of conflicting loyalties to the corporation and his own private interest. We find no conflict

between these cases and the substance of the trial court's instructions. Both *Ohio Drill & Tool* and *Seagrave v. Mount* simply apply the rule that directors owe a duty of loyalty to the corporation and are not entitled to the discretion permitted by the business judgment rule when they are interested in a corporate control transaction which is the subject of their business judgment as directors. The trial court's instructions may not possess the clarity of a restatement, but in explicitly telling the jury that a fiduciary "must give his undivided loyalty" to the corporation and breaches his duty if he intentionally acts contrary to the best interests of the corporation, the court accurately stated the law in a manner consistent with *Ohio Drill & Tool* and *Seagrave v. Mount*.

In light of recent Supreme Court decisions severely restricting the substantive content of the federal securities laws as applied to tender offers and takeovers, and emphasizing the traditional role of state law in regulating the fairness of corporate control transactions, *see, e.g., Schreiber v. Burlington Northern*, ____ U.S. ____, 105 S.Ct. 2458, 86 L.Ed.2d 1 (1985); *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977), we have no wish to narrow the scope of state law fiduciary duties. Tender offers almost always present a potential conflict of interest for managers. But we cannot accept plaintiffs' underlying contention that in the context of corporate control transactions the burden of proof shifts to the directors to establish the fairness to shareholders of any transaction that would have the effect of retaining the directors' control. We reject the view that the stock option agreement and employment assurance alone placed the directors in a position of conflicting loyalties so that the burden of proof shifted to the defendants. Although there are no reported Ohio decisions addressing this contention, it has been rejected overwhelmingly in recent decisions from other jurisdictions involving an attack on the actions of corporate directors allegedly taken for the purpose of preserving corporate control in the face of a hostile tender offer, *Panter v. Marshall Field & Co.*, 646 F.2d 271, 295 (7th Cir.), *cert. denied*, 454 U.S. 1092, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981);

Crouse-Hinds Co. v. InterNorth, Inc., 634 F.2d 690, 701-03 (2d Cir. 1980); *Treadway Cos. v. Care Corp.*, 638 F.2d 357, 381 (2d Cir. 1980), and the general rule remains that directors carry the burden of showing that a transaction is fair and in the best interests of shareholders only *after* the plaintiff has made a prima facie case showing that the directors have acted in bad faith or without requisite objectivity. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984); ALI, Principles of Corporate Governance: Analysis and Recommendations, § 4.01 at 6, 11 (Tent. Draft No. 4, April 12, 1985) (protections of business judgment rule removed only if a challenging party can sustain his burden of showing the director was not acting in good faith or with disinterest, or was not informed as to the subject of his business judgment).

It may be that some corporate control events, such as the payment of greenmail, should shift the burden of proof and invoke close judicial scrutiny, *see* Note, *Greenmail: Targeted Stock Repurchase and the Management-Entrenchment Hypothesis*, 98 Harv.L.Rev. 1045, 1056-59 (1985), but here the transaction merely provided that long term stock options—held by upper level management only and not by the outside directors—would be cashed out at the anticipated average price in the two-tier transaction, and that the officer-directors would be continued in their present positions, although their employment remained terminable at will. There were no severance payments or "golden parachutes" involved, and unlike *Norlin*, where the board of directors effectively assured itself voting control over the company in order to ward off hostile stock purchases by issuing new common and preferred to its wholly owned Panamanian subsidiary and to a newly created employee stock ownership plan, the ultimate decision on the proposed transaction with Steel was made by the shareholders in deciding to tender their shares and vote for the merger, thus preserving the fundamental principle of corporate governance that shareholders must control decisions affecting the corporation's survival as a legal entity.

B. Marathon's Liability for Breach of Fiduciary Duty

The plaintiffs maintain that the District Court erred in

instructing the jury that Marathon had no fiduciary duty to its shareholders and that plaintiffs' claim for breach of fiduciary duty was limited to its claim against Marathon's directors. Plaintiffs say that Marathon itself owed a fiduciary duty to its shareholders because the fiduciary duty of an officer or director derives from his position as a representative of the corporation, or alternatively, that the fiduciary duty of an officer or director creates a fiduciary duty in the corporation.

Plaintiffs' argument is based on a fundamental misunderstanding of the nature of the corporate director's fiduciary relationship. A corporation is a legal entity created in derogation of the common law and the obligations of the corporation are defined by statute, as are the rights of shareholders. Under O.R.C. §§ 1701.59(A) and (B), except where the law, articles of incorporation or corporate regulations require action to be authorized by shareholders, all of the authority of a corporation is to be exercised under the direction of the corporation's directors, who must act in a manner they reasonably believe to be in the corporation's best interests. The directors stand, roughly, as trustees over the corporation, administering it for the benefit of the beneficial owners, the shareholders. *See* 3 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 848 (1975 ed.). Liability for breach of the directors' fiduciary obligation could not possibly run against the corporation itself, for this would create the absurdity of satisfying the shareholders' claims against the directors from the corporation, which is owned by the shareholders. There is not, and could not conceptually be any authority that a corporation as an entity has a fiduciary duty to its shareholders. *See Jordan v. Global Natural Resources, Inc.*, 564 F.Supp. 59, 68 (S.D.Ohio 1983).[9]

Similarly, although a corporation may be held vicariously liable to third parties for acts of directors and officers within

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9. The cases plaintiffs cite for the proposition that a corporation may have a fiduciary duty to shareholders all involve situations where the corporation owed a fiduciary duty to minority shareholders of a second corporation of which it was majority shareholder. *See, e.g., Southern Pacific Co. v. Bogert*, 250 U.S. 483, 491-92, 39 S.Ct. 533, 536-37, 63 L.Ed. 1099 (1919); *Zahn v. Transamerica Corp.*, 162 F.2d 36, 42 (3d Cir. 1947).

their authority as representatives of the corporation, *see, e.g., Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011, 101 S.Ct. 566, 66 L. Ed.2d 469 (1980), such vicarious liability has been sparingly imposed, primarily on brokerage firms in dealings with customers because of the special duty owed by brokers to customers. *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 182 (3d Cir. 1981). Plaintiffs have cited no case in which a corporation has been held vicariously liable to its shareholders for its directors' breach of fiduciary duty, and such a result would be flatly inconsistent with the rationale of vicarious liability, since it would shift the cost of the directors' breach from the directors to the corporation and hence to the shareholders, the class harmed by the breach.

C. Joint and Several Liability of the Marathon Defendants, and Other State Law Claims

The plaintiffs assert that the jury verdict form on breach of fiduciary duty was erroneous because it did not permit the jury to find that some Marathon directors were liable while others were not and essentially instructed the jury that only joint and several liability could be found. Plaintiffs say this verdict form was particularly prejudicial because some of the directors, the officer-directors in particular, had greater knowlege and conflicts of interest than did others, and because of the inclusion of a prominent national hero, astronaut Neil Armstrong, an outside director, along with the other directors.

The Marathon board unanimously approved the merger with Steel, and unanimously agreed to oppose Mobil's offer, and the evidence was uncontroverted that these decisions were taken by the board as a whole. (*See* Hoopman testimony at T. 832-37, A. 358-63.) The law is clear that directors and officers of a corporation are jointly and severally liable if they jointly participate in a breach of fiduciary duty or approve, acquiesce in, or conceal a breach by a fellow officer or director. *Ohio Drill & Tool Co. v. Johnson*, 625 F.2d at 742; *Nienaber v. Katz*, 69 Ohio App. 153, 43 N.E.2d 322 (1942); 3 W. Fletcher,

Cyclopedia of the Law of Private Corporations § 1002, at 546-47 (1975 ed.). Moreover, there is no authority in Ohio for the proposition that outside directors must be treated differently with respect to joint decisions by the entire board.

Plaintiffs also contend that Steel could have been found jointly liable at the tender offer stage for knowingly joining in a breach of fiduciary duty by Marathon's directors, but there is no authority for this exceptionally problematic notion, and the contention is in any event moot given that the jury, on the basis of correct instructions, found unanimously that Marathon's directors had not breached their fiduciary duty. Plaintiffs' attack on the trial court's failure to allow emendation of the complaint to include a claim that statements regarding the nature of the Strong and First Boston reports in the proxy materials were false and misleading is equally without merit. Similarly without merit is the plaintiffs' contention that the court's decision to admit the testimony of class member Fishbein was reversible error, and we find all other miscellaneous points of error raised by the plaintiffs to be groundless.

Accordingly, the judgment of the District Court is affirmed.

Appendix B

No. 84-3215.

UNITED STATES COURT OF APPEALS, SIXTH CIRCUIT.

Argued Jan. 22, 1985.

Decided Sept. 13, 1985.

Irving STARKMAN, M.D., Trustee of the Irving Starkman, M.D., S.C. Defined Benefit Pension Fund and Trust, on behalf of himself and all others similarly situated, Plaintiff-Appellant,

v.

MARATHON OIL COMPANY, an Ohio corporation, H.D. Hoopman, C.H. Barre, V.G. Beghini, H.H. Hering, and W.E. Swales, Defendants-Appellees.

Lawrence Walner, Lawrence Walner & Associates, Chicago, Ill., Larry A. Temin, Strauss, Troy & Ruehlmann Co., Cincinnati, Ohio, Edward Slovick, argued, James Gordon, Chicago, Ill., for plaintiff-appellant.

Murray S. Monroe, Cincinnati, Ohio, John M. Newman, John W. Edwards, III, Robert R. Weller, John L. Strauch, argued, Cleveland, Ohio, James T. Griffin, Michael P. Mullen, William J. Raleigh, Chicago, Ill., for defendants-appellees.

Before MERRITT and KENNEDY, Circuit Judges, and PECK, Senior Circuit Judge.

MERRITT, Circuit Judge.

Like *Radol v. Thomas*, 772 F.2d 244 (6th Cir. 1985), this action arises out of U.S. Steel's November, 1981 acquisition and eventual merger with Marathon Oil Company. The plaintiff here, Irving Starkman, was a Marathon shareholder until selling his shares on the open market for $78 per share on November 18, 1981, the day before U.S. Steel's tender offer

for 51% of Marathon's outstanding shares at $125 per share was announced.[1] On October 31, 1981, Mobil Oil had initiated its takeover bid for Marathon, a bid which Marathon actively resisted by urging its rejection by Marathon shareholders and by seeking and eventually finding a "white knight" or alternative, friendly merger partner-tender offeror, U.S. Steel. Starkman claims that Marathon's board violated Rule 10b-5 and its fiduciary duty to him as a Marathon shareholder by failing to disclose various items of "soft" information—information of less certainty than hard facts—in its public statements to shareholders during the period after Mobil's hostile tender offer and prior to Steel's friendly tender offer. In particular, he says that Marathon should have told shareholders that negotiations were underway with U.S. Steel prior to the consummation of those negotiations in an agreement, and that internal and externally-prepared asset appraisals and five-year earnings and cash flow projections should have been disclosed to shareholders so that they could make a fully informed choice whether to sell their shares or gamble on receiving a higher price in a possible Steel-Marathon merger.

The District Court granted summary judgment for Marathon, finding that these items of soft information had either been sufficiently disclosed or were not required to be disclosed because their nondisclosure did not render materially misleading Marathon's other affirmative public statements. For the reasons stated below, we affirm the judgment of the district Court.

I. BACKGROUND

We have discussed the background and structure of U.S. Steel's acquisition of Marathon Oil at some length in *Radol v. Thomas*, 772 F.2d 244 (6th Cir. 1985), and our attention here

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1. Although Starkman still styles his case as a class action, the District Court twice denied motions for class determination, and this issue is not before us on appeal.

will therefore be focused on the facts which are especially relevant to Starkman's Rule 10-5 claims.[2]

In the summer of 1981, Marathon was among a number of oil companies considered to be prime takeover targets. In this atmosphere, Marathon's top level management began preparations against a hostile takeover bid. Harold Hoopman, Marathon's president and chief executive officer, instructed the company's vice presidents to compile a catalog of assets. This document, referred to as the "Strong Report" or "internal asset evaluation," estimated the value of Marathon's transportation, refining and marketing assets, its other equipment and structures, and the value of proven, probable, and potential oil reserves as well as exploratory acreage. Hoopman and John Strong, who was responsible for combining materials received from various divisions into the final report, both testified that the Strong report was viewed as a "selling document" which placed optimistic values on Marathon's oil and gas reserves so as to attract the interest of prospective buyers and ensure that Marathon could either ward off an attempt to capture Marathon at a bargain price or obtain the best offer available.

In estimating proven, probable, and potential reserves and exploratory acreage, the Strong Report was based on information that was not available to the general public, for example in annual reports, because only the value of proven reserves was normally included in such public documents. The Strong Report defined proven reserves as those actually producing, probable reserves as reserves for properties where some production had been established and additional produc-

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2. Judge Rubin disposed of this suit on summary judgment after the trial in *Radol v. Thomas*. Although very limited discovery was allowed prior to the summary judgment order, Starkman moved to supplement the record on this appeal, with a large amount of evidence taken in *Radol v. Thomas*, including the Strong and First Boston reports, Doc. 91, and this motion was unopposed by Marathon and was granted. Doc. 98. All the facts discussed in this section are properly in the record in this appeal as supplemented, but references to their physical location in the *Radol v. Thomas* appellate record will be explicitly noted where appropriate. Otherwise, "A" denotes the appendix in this appeal.

tion was likely, and potential reserves as reserves for properties where production had not yet been established but where geologic evidence supported wildcat drilling.[3] These reserves were valued using a discounted cash flow methodology, under which the present value of oil reserves is calculated by summing risk discounted expected net revenues from the particular field over the life of the field, and then discounted into present value by dividing by an estimated interest rate. This valuation method, a standard procedure for determining the cash value of oil and gas properties, required projections of price and cost conditions prevailing as far as 20 years into the future. For example, the Strong Report assumed that the rate of increase in oil prices would average over 9% per year from 1980-1990.

Using this methodology, the Strong Report valued Marathon's net assets at between $19 billion and $16 billion (depending on which set of interest rates was used to discount back to present value), a per share value of between $323 and $276. The value of oil and gas reserves made up $14 billion of the $19 billion estimate and $11.5 billion of the $16 billion estimate. A similar report using identical methodology was prepared in mid-July 1981 by the investment banking firm of First Boston, which had been hired by Marathon to assist in preparing for potential takeover bids. The First Boston Report was based only upon proven and probable oil reserves and was also intended to be used as a "presentation piece" to avoid a takeover or maximize the price obtained in a takeover. It placed Marathon's value at between $188 and $225 per share.

Some perspective on the values arrived at in the Strong and First Boston reports can be gained from other, publicly available appraisals of Marathon's assets prepared during 1981. The Herold Oil Industry Comparative Appraisal placed Marathon's appraised value at $199 per share, and two other reports by securities analysts said Marathon had an appraised value of between $200 and $210 per share.[4]

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3. These definitions appear at pages 1160-1162 in the Appendix in *Radol v. Thomas*.

4. *See Radol v. Thomas* appendix at 2585, 2590.

Marathon's market value, however, was well below these appraised values. On October 29, 1981, Marathon closed at $63.75 per share. The next day, Mobil Oil announced its tender offer to purchase up to approximately 68% of outstanding Marathon common stock for $85 per share in cash. Mobil proposed to follow the tender offer with a going private or freezeout merger in which the remaining shareholders of Marathon would receive sinking fund debentures worth approximately $85 per share.

On October 31, 1981, Marathon's board of directors met in emergency session and unanimously decided that the Mobil offer was "grossly inadequate" and approved a vigorous campaign to persuade Marathon shareholders not to tender to Mobil, and to simultaneously seek a "white knight." On November 11 and 12, Marathon's Board made public statements to the shareholders recommending rejection of Mobil's bid as "grossly inadequate" and against the best interests of the company. We explore these statements in more detail below, as they are a primary focus of Starkman's claims of inadequate disclosure. However, at the time these statements to shareholders were made, Marathon representatives had already contacted all of the 30 to 35 companies who could possibly undertake an acquisition topping Mobil's bid, and, in particular, had begun negotiations with U.S. Steel on November 10. The Strong and First Boston reports were given to Steel on that same day, on the condition that they be kept confidential, and on November 12, Marathon's vice president for finance delivered five-year earnings forecasts and cash flow projections to Steel in Pittsburgh.

On November 17, Hoopman and David Roderick, Steel's president, reached agreement on the terms of Steel's purchase of Marathon, and, after Board approval, an agreement was signed on November 18, 1981. Under the terms of the agreement, Steel would make a tender offer for up to 31 million shares (about 51%) of Marathon stock for $125 per share in cash, to be followed by a merger proposal in which each remaining Marathon shareholder would receive one $100 face value, 12 year, 12½ per cent guaranteed note per share of

common stock. On November 19, Steel mailed its tender offer to Marathon shareholders, and Hoopman sent a letter to Marathon shareholders describing the two-stage deal and stating the opinion of Marathon's Board that the agreement was fair to Marathon shareholders. Steel's offer was successful, with over 91% of the outstanding shares tendered, and the second stage freezeout merger was approved by a two-thirds majority of the remaining shareholders in February, 1982.

II. MARATHON'S PUBLIC STATEMENTS AND DISPOSITION BELOW

There are three public statements by Marathon management at issue here. First, Marathon's November 11, 1981, press release, which states, in pertinent part, that:

> Our Board of Directors has determined that Mobil Corporation's unsolicited tender offer is grossly inadequate. The offer is not in the best interests of Marathon Oil or its shareholders. It doesn't reflect current asset values and it doesn't permit the long-term investor the opportunity to participate in the potential values that have been developed.
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> * * *
>
> We plan to do everything we possibly can to defeat this offer. We are determined to stay independent.

A. 187.

The next day, as required by Rule 14e-2, 17 C.F.R. § 240.14e-2 (1984), Marathon mailed a letter to its shareholders stating its position regarding Mobil's tender offer. The letter urged rejection of the offer, stating that Marathon's Board was "convinced that the Mobil offer is grossly inadequate and does not represent the real values of the assets underlying your investment in Marathon." A. 182. The letter described a number of alternative courses of action that were being considered by the Board, including "repurchase of Marathon shares, acquisition of all or part of another company, a business combination with another company, (and) the decla-

ration of an extra ordinary dividend and a complete or partial liquidation of the Company," *id.*, and concluded by again urging rejection of Mobil's attempt to "seize control of Marathon's assets at a fraction of their value," and stating that "[w]e are convinced that you and our other shareholders would be well served if Marathon remains independent." *Id.*

Attached to this letter was a copy of Marathon's Schedule 14D-9, filed pursuant to Rule 14d-9, 17 C.F.R. § 240.14d-9, in which the board informed the SEC that it had recommended rejection of the Mobil offer as "grossly inadequate." Item 4(b)(iv) of Marathon's Schedule 14D-9 listed as a factor supporting this recommendation the board's belief that based on current economic and market factors, "this is an extremely inopportune time to sell the Company and, in any event, that its shareholders would be better served if the Company were to remain independent." A. 92. Item 7 of this same schedule described "Certain Negotiations and Transactions" by Marathon:

> At a meeting of the Board of Directors held on October 31, 1981, the Board considered and reviewed the feasibility and desirability of exploring and investigating certain types of possible transactions, including, without limitation, repurchases of Company Common Shares, the public or private sale of equity or other securities of the Company, a business combination between the Company and another company, the acquisition of a significant interest in or the entire Company or of one or more of its significant business segments by another company, a joint venture between the Company and one or more other companies, the acquisition by the Company of all or part of the business of another Company, a complete or partial liquidation of the Company or the declaration of an extraordinary dividend. After considerable discussion, the Board resolved that it was desirable and in the best interest of the Company and its shareholders to explore and investigate, with the assistance and advice of First Boston, such transactions, although the Board noted that

> the initiation or continuation of such activities may be dependent upon Mobil's future actions with respect to the Mobil Offer. There can be no assurance that these activities will result in any transaction being recommended to the Board of Directors or that any transaction which is recommended will be authorized or consummated.

A. 96

Starkman argues that the failure of any of these communications to disclose the Strong and First Boston reports and the five-year earnings and cash flow projections constituted an omission of material facts which rendered these communications materially misleading, and that Marathon not only failed to adequately disclose its search for a white knight and its negotiations with Steel but actually gave the false impression that the Board was endeavoring to preserve Marathon as an independent entity. He argues that the Strong and First Boston reports, the five-year cash and earnings projections, and the fact of ongoing negotiations with U.S. Steel were all material facts because knowledge of them would have affected a reasonable shareholder's evaluation of the likelihood that Marathon would succeed in negotiating a higher price takeover, and thereby affect such a shareholder's decision to sell his shares. He contends that shareholders were not adequately informed of Marathon management's search for a "white knight" and of the negotiations with Steel, and that failure to disclose more information regarding these negotiations rendered statements suggesting that Marathon might remain independent materially misleading. Similarly, Starkman contends that if he had been told of the Strong and First Boston reports and the five-year earnings and cash flow projections, and also that Marathon management was using these figures in seeking an alternative bidder, then he would have anticipated a much higher bid than he did, and that failure to release this information rendered materially misleading the affirmative statements Marathon did make.

In his brief on this appeal, Starkman has repeatedly mischaracterized the decision of the District Court as holding

that none of the information Starkman contends should have been disclosed was material. To understand the District Court's holding in this case, it is important to note at the outset that in *Radol v. Thomas*, 772 F.2d 244 No. 83-3598 (6th Cir. 1985), the plaintiffs claimed that the same asset appraisals at issue here should have been disclosed by Steel in its tender offer and by Marathon in its statements recommending that shareholders accept Steel's offer. Judge Rubin presided over both the present suit and *Radol*, and in *Radol* he denied the defendant's motion for summary judgment on the issue of whether the asset appraisals should have been disclosed at the time of Steel's tender offer on the ground that the reports were not, as a matter of law, immaterial, and he sent the materiality of these reports to the jury. *See Radol v. Thomas*, 566 F.Supp. 586, 594 (S.D.Ohio 1983).

In granting summary judgment for Marathon in the present action, however, Judge Rubin found that the net asset values stated in the Strong and First Boston reports were perfectly consistent with Marathon's repeated public assertion that Mobil's bid was "grossly inadequate" in light of the true value of Marathon's assets, and that disclosure of the reports was not required under Rule 10b-5 because "disclosure of information which is consistent with other statements made is obviously not necessary in order to make those statements not misleading. Such disclosure would simply reinforce, rather than correct or modify, the statements made." A. 16. As to the claim that nondisclosure of the reports rendered misleading Marathon's statements that the best result would be for the company to remain independent, the District Court said that these statements were not misleading when placed in the context of the repeated assertion that Mobil's offer was "grossly inadequate" and that alternatives including merger into another company were under consideration. A. 17.

The District Court summarily disposed of the claim that the five-year earnings and cash flow projections should have been disclosed, concluding that disclosure of such information is simply not required under *Marsh v. Armada Corp.*, 533 F.2d 978, 986-87 (6th Cir. 1976), *cert. denied*, 430 U.S. 954,

97 S.Ct. 1598, 51 L.Ed.2d 803 (1977), and *Arber v. Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir. 1974), *cert. denied*, 419 U.S. 830, 95 S.Ct. 53, 42 L.Ed.2d 56 (1974). A. 18.

As to disclosure of the negotiations with Steel, the District Court cited *Reiss v. Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983), and *Staffin v. Greenberg*, 672 F.2d 1196, 1206 (3d Cir. 1982), in ruling that Marathon's 14D-9 disclosure that the acquisition of all or part of another company, or merger with another company, was being considered as an alternative to the Mobil offer sufficed to meet whatever disclosure obligation may have existed. A. 19-20.

III. DISCUSSION

A. Introduction

Pursuant to Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C.§ 78j(b) (1982), which prohibits the use of any "manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe," "in connection with the purchase or sale of any security," the SEC promulgated Rule 10b-5, which provides in pertinent part that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> * * *
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . .

17 C.F.R. § 24.1b-5 (1984).

Aptly described as a "judicial oak which has grown from little more than a legislative acorn," *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737, 95 S.Ct. 1917, 1926, 44 L.Ed.2d 539 (1975), Rule 10b-5 has been the source of a

wide-ranging federal common law of securities fraud, clearly applicable to the tender offer context, provided that, as here, there has been a purchase or sale of a security. *See* 3 L. Loss, *Securities Regulation* 1445 (2d ed. 1961).

Despite occasional suggestions by commentators, *see, e.g.*, Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose*, 67 Geo.L.J. 935 (1979), and the courts, *Zweig v. Hearst Corp.*, 594 F.2d 1261, 1266 (9th Cir. 1979), that Rule 10b-5 imposes an affirmative obligation on the corporation to disclose all material information regardless of whether the corporation has made any other statements, the established view is that a "duty to speak" must exist before the disclosure of material facts is required under Rule 10b-5. *See Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978, 984 (3d Cir. 1984) (citing *Chiarella v. United States*, 445 U.S. 222, 235, 100 S.Ct. 1108, 1118, 63 L.Ed.2d 348 (1980); *Staffin v. Greenberg*, 672 F.2d 1196, 1202 (3d Cir. 1982)). Provided that such a duty to speak exists, a further limitation on the duty to disclose is imposed by the requirement that only misstatements of material facts and omissions of material facts necessary to make other required statements not misleading are prohibited by Rule 10b-5. The Supreme Court's definition of "material" in the context of an alleged violation of Rule 14a-9, governing disclosure requirements in proxy statements, has been adopted for cases involving Rule 10b-5 in the tender offer context. *Flynn v. Bass Brothers Enterprises*, 744 F.2d at 985; *Staffin v. Greenberg*, 672 F.2d at 1205; *Panter v. Marshall Field & Co.*, 646 F.2d 271, 282 (7th Cir.), *cert. denied*, 454 U.S. 1092, 102 S.Ct. 658, 70 L.Ed.2d 631 (1981). That definition reads as follows:

> An omitted fact is material if there is substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with [*Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970)] general description of materiality as a requirement that "the defect have a significant propensity to affect the voting process."

> It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449, 96 S.Ct. 2126, 2132, 48 L.Ed.2d 757 (1976).

In structuring the disclosure duties of a tender offer target, we begin therefore with the basic proposition that only material facts—those substantially likely to affect the deliberations of the reasonable shareholder—must be disclosed, and then *only* if the nondisclosure of the particular material facts would make misleading the affirmative statements otherwise required by the federal securities laws and SEC regulations.

Our adherence to this basic proposition ensures that target management's disclosure obligations will strike the correct balance between the competing costs and benefits of disclosure. The benefits of disclosure in ensuring that shareholders who are suddenly faced with a tender offer will not be forced to respond without adequate information are clearly recognized in Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e), which somewhat broadens the reach of Rule 10b-5 to statements made "in connection with any tender offer" and which provides the statutory authority for SEC rules imposing affirmative disclosure obligations on tender offer targets.[5]

5. Section 14(e) provides, in part, that:

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer. . . .

On the other hand, tender offers remain essentially contests in which participants on both sides act under the "stresses of the marketplace," and "[p]robably there will no more be a perfect tender offer than a perfect trial." *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 948 (2d Cir. 1969) (Friendly, J.). Under these conditions, imposing an "unrealistic requirement of laboratory conditions," *id.*, would place target management under the highly unpredictable threat of huge liability for the failure to disclose, perhaps inducing the disclosure of mountains of documents and hourly reports on negotiations with potential tender offerors, a deluge of information which would be more likely to confuse than guide the reasonable lay shareholder and which could interfere with the negotiation of a higher tender offer and actually reduce the likelihood that a shareholder will benefit from a successful tender offer at a premium over the market. It is with these competing considerations in mind that we turn to the particular disclosure claims made here.

B. Assets Appraisals and Earnings Projections

We first address Starkman's contention that Marathon should have disclosed the Strong and First Boston reports and the five-year earnings projections and forecasts given to Steel. Under the authority of Section 14(e) of the Williams Act, the SEC requires a tender offer target to make two affirmative statements regarding an offer. First, Rule 14e-2 requires that the target company mail or publish a statement to its shareholders within 10 days of the tender offer stating its position (or stating it cannot take a position) and giving reasons for the position. Under Rule 14d-9, a Schedule 14D-9 must be filed with the SEC "as soon as practicable" after the recommendation letter is sent to shareholders. The information to be included in the Schedule 14D-9 is described in 17 C.F.R. § 14d-101. Significantly, although Item 4 of the Schedule 14D-9 is to contain a statement of the reasons for the target's position with respect to the offer, and Item 8 requires disclosure of any additional information as "may be necessary to make the required statements, in light of the circumstances

under which they are made, not misleading" neither the shareholder recommendation letter nor the Schedule 14D-9 must contain internal asset appraisals, appraisals done by outside consultants such as First Boston, or earnings and cash flow projections.

Since there is no SEC rule specifically requiring the disclosure of this information, we must determine whether Rule 10b-5 requires its disclosure as material information, the nondisclosure of which would render misleading other statements made by Marathon. The starting point in this analysis is the underlying regulatory policy toward disclosure of such information, since regulatory rules reflect careful study of general conditions prevailing in the securities marketplace and provide guidelines upon which corporate officers and directors are entitled to rely.

The SEC's policy toward the inclusion of appraised asset valuations, projections and other "soft" information in proxy materials, tender offers and other disclosure documents has undergone a gradual evolution toward *allowing* the inclusion of such information in some special contexts, provided that the assumptions and hypotheses underlying predicted values are also disclosed.

In 1976 future earnings projections were deleted from a list of examples of potentially misleading disclosures in proxy statements in the note which followed Rule 14a-9. *See* Securities Act Release No. 5699, *reprinted in* [1975-76 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 80, 461 (1976). And, effective July 30, 1979, the SEC adopted a "safe harbor" rule for projections, under which a statement containing a projection of revenues and earnings would not be considered to be a materially misleading misstatement or omission for purposes of liability under the federal securities laws provided the statement was prepared with a reasonable basis and was disclosed in good faith. *See* Securities Act Release No. 6084 *reprinted in* [1979 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 82,117, at 81,939 (June 25, 1979).

With respect to asset appraisals, Rule 13e-3, 17 C.F.R. § 240.13e-3, requires disclosure of the information called

for by Items 7, 8, and 9 of Schedule 13E-3, 17 C.F.R. § 240.13e-100, in the context of freezeout mergers. Item 8 of Schedule 13E-3 requires disclosure of factors important in determining the fairness of such a transaction to unaffiliated shareholders, and these factors include liquidation value; Item 9 of that same schedule says that a summary of any outside appraisal must be furnished, with the summary including a discussion of the procedures and methods of arriving at the findings and recommendations of the appraisal. However, a 1979 SEC-proposed amendment under which an issuer would have to disclose any projection given to an appraisal furnisher was never adopted, *see* 2 Fed.Sec.L.Rep. (CCH) ¶23-706, at 17,245-21 through 21A, and, even more importantly, in *Radol v. Thomas*, 772 F.2d 244 No. 83-3598, (6th Cir. 1985), we have rejected the position that SEC rules regarding freezeout mergers and proxies should determine the disclosure obligations of target management in the first stage of a two-tier tender offer.[6]

Finally, we note that until March, 1982, Regulation S-K, the source for disclosure obligations in annual reports, registration documents and other documents that must be filed with the SEC, provided in Instruction 2 to Item 2(b) that estimates of probable or possible oil and gas reserves should not be disclosed in any document publicly filed with the SEC. *See* Securities Act Release No. 6008, *reprinted in* [1978 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 81, 768, at 81,104 (Dec. 19, 1978). The underlying reason was that "estimates of prob-

6. In addition, while the note to Rule 14a-9 lists "predictions as to specific future market values" as a potentially misleading proxy statement disclosure, the SEC in 1980 authorized disclosure of good faith appraisals made on a reasonable basis in proxy contests in which a principal issue is the disposition of the issuer's assets, provided that the valuations are accompanied by "disclosure which facilitates shareholders' understanding of the basis for and limitations on the projected realizable values." Exchange Act Release No. 34-16833, *reprinted in* 3 Fed.Sec.L.Rep. (CCH) ¶ 24,117 (May 23, 1980). This same release cautioned, however, that where "valuations are so qualified and subject to material limitations and contingencies, inclusion in proxy soliciting material of specific realizable values may be unreasonable." 3 Fed.Sec.L.Rep. (CCH) at 17, 621-13.

able or possible reserves and any value thereof are not sufficiently reliable to be included . . . and may be misleading to investors." *Id.* In March, 1982, well after Steel's tender offer, Item 102 of Regulation S-K was amended to *allow* disclosure of "estimated" as well as proved reserves where such estimates have previously been provided to a person who is offering to acquire or merge with the subject company, *see* Securities Act Release No. 6383, *reprinted in* [1937-1982 Accounting Series Release Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 72,328, at 63,003 (March 3, 1982). The Strong and First Boston reports contain estimates of probable and possible reserves, and the disclosure of this information was actually prohibited at the time of Steel's tender offer, and only *permitted* since that time.

Thus, at the time of Steel's tender offer, the SEC did not require disclosure of earnings projections in any context, and required disclosure of asset appraisals, in summary form, only in the special context of freeze-out mergers, which differs markedly from the setting of a first-stage tender offer. Although the SEC allowed disclosure of projections, provided they were prepared on a "reasonable basis" and in "good faith," and also allowed disclosure of similarly supported asset appraisals in some proxy contests, it forbade the disclosure of estimates of probable and potential oil and gas reserves, a major component of the Strong and First Boston appraisals. Absent compelling authority to the contrary, we are reluctant to impose liability on Marathon for failing to disclose asset appraisals based on hypothetical valuations which the SEC did not then permit to be disclosed in most contexts, particularly since Section 23(a) of the Securities and Exchange Act, 15 U.S.C. § 78w(a)(1) provides that no liability under the federal securities laws shall be imposed for "any act done or omitted in good faith conformity with a rule, regulation, or order of the Commission." *See Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1292-94 (2d Cir. 1973) (refusing, per Friendly, J., to impose liability on the basis of an ex-post modification in SEC policy for non-disclosure in 1963 merger proxy statement of asset appraisals when it was an "article of faith"

among securities lawyers in 1963 that such appraisals could not be included in a proxy statement.).

Rather than suggesting a duty to disclose the Strong and First Boston reports, however, our cases firmly establish the rule that soft information such as asset appraisals and projections must be disclosed only if the reported values are virtually as certain as hard facts.

This Court has recently held that a target's failure to disclose an appraisal based on five-year cash flow and earnings projections and intended to be used as a selling document in ongoing merger discussions did not violate Rule 10b-5. *Biechele v. Cedar Point, Inc.*, 747 F.2d 209 (6th Cir. 1984). Chief Judge Lively's opinion for the court reasoned that the report was a "selling document" which "contained projections and speculative assumptions which were little more than predictions of future business success," and valuations based on the replacement cost of assets which could be misleading to shareholders, since they varied from balance sheet information prepared according to accepted accounting principles. *Id.* at 216. Similarly, in *James v. Gerber Products Co.*, 587 F.2d 324, 327 (6th Cir. 1978), we held that the failure to disclose interim earnings reports in connection with a shareholder's sale of stock back to the issuing company did not violate Rule 10b-5, because "such sales figures, projections, forecasts and the like only rise to the level of materiality when they can be calculated with substantial certainty." And in *Arber v. Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir.), *cert. denied*, 419 U.S. 830, 95 S.Ct. 53, 42 L.Ed.2d 56 (1974), another case involving a corporate stock repurchase, then Judge McCree said that while a fixed plan of future corporate activity might, under some circumstances, be viewed as a material fact, Section 10(b) and Rule 10b-5 did not require a corporate insider to disclose his educated guesses or predictions, and "[i]n short, the law mandates disclosure only of existing material facts. It does not require an insider to volunteer any economic forecast." *See also Marsh v. Armada Corp.*, 533 F.2d 978, 987 (6th Cir. 1976), *cert. denied*, 430 U.S. 954, 97 S.Ct. 1598, 51 L.Ed.2d 803 (1977) (failure to make a

projection of future earnings in freeze-out merger proxy statement not actionable under Rule 10b-5).

Our cases fully support a rule under which a tender offer target must disclose projections and asset appraisals based upon predictions regarding future economic and corporate events only if the predictions underlying the appraisal or projection are substantially certain to hold. An example is when the predictions in fact state a fixed plan of corporate activity. If a target chooses to disclose projections and appraisals which do not rise to this level of certainty, then it must also inform the shareholders as to the basis for and limitations on the projected realizable values.[7]

The Third Circuit has enunciated a different test, under which "courts should ascertain the duty to disclose asset valuations and other soft information on a case by case basis, by weighing the potential aid such information will give the shareholder against the potential harm, such as undue reliance, if the information is released with a proper cautionary note." *Flynn v. Bass Brothers Enterprises,* 744 F.2d at 988. The court listed several factors the courts have considered in determining the reliability of soft information, including the qualifications of those who prepare the appraisal, the degree of certainty of the data on which it was based, and the purpose for which it was prepared. 744 F.2d at 986, 988 (compiling cases); *see also Panter v. Marshall Field,* 646 F.2d at 292-93.

By its very nature, however, this sort of judicial cost-benefit analysis is uncertain and unpredictable, and it moreover neglects the role of the market in providing shareholders with information regarding the target's value through compet-

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7. We note that this rule is fully consistent with the recent statement by the SEC Advisory Committee on Tender Offers that "current disclosures of projections and valuations given to a bidder by a target company are essentially meaningless and can be misleading without disclosure of the underlying assumptions," and with that Committee's recommendation that "[w]here the bidder discloses projections or asset valuations to target company shareholders, it must include disclosure of the principal supporting assumptions provided to the bidder by the target." *See* SEC Advisory Committee on Tender Offers, Report of Recommendations, at 29 (July 8, 1983).

ing tender offers. Our approach, which focuses on the certainty of the data underlying the appraisal or projection, ensures that the target company's shareholders will receive all essentially factual information, while preserving the target's discretion to disclose more uncertain information without the threat of liability, provided appropriate qualifications and explanations are made.

Under this standard, Marathon plainly had no duty to disclose the Strong and First Boston reports, because these reports contained estimates of the value of probable, potential and unexplored oil and gas reserves which were based on highly speculative assumptions regarding the path of oil and gas prices, recovery rates and the like over a period of thirty to fifty years. Disclosure of such estimated values could well have been misleading without an accompanying mountain of data and explanations. There is no reported case actually holding that disclosure of appraised values of oil and gas reserves is required, and several which agree with our decision that such disclosure is not required.[8]

Similarly, Marathon had no duty to disclose the five-year earnings and cash flow projections given to Steel and First Boston. This information does not rise to the level of substantial certainty triggering a duty to disclose. *Biechele v. Cedar Point; James v. Gerber Products Corp.*, both *supra.*

Further, disclosure of the asset appraisals and earnings and cash flow projections was not required in order to ensure that other statements in Marathon's 14D-9 and in its letter recommending rejection of Mobil's bid were not misleading. Marathon stated that Mobil's $85 offer was "grossly inade-

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8. *See, e.g., Sunray v. DX Oil Co. v. Helmerich & Payne, Inc.*, 398 F.2d 447, 450-51 (10th Cir.1968) ("any statement concerning oil reserves other than in the category of 'proved' could certainly be misleading to any investor other than one who is an expert in the industry"); *Caspary v. Louisiana Land and Exploration Co.*, 579 F.Supp. 1105 (S.D.N.Y.1983), *aff'd*, 725 F.2d 189 (2d Cir.1984) (no duty to disclose internal projections regarding oil recovery rates and exploration costs); *Bradshaw v. Jenkins*, [1983-84 Transfer Binder] Fed.Sec.L.Rep. (CCH) ¶ 99,719 (W.D.Wash. March 9, 1984) (no duty to disclose consultant's estimated value of energy loan portfolio).

quate" and disclosure of highly uncertain information indicating that Marathon had a net asset value of over $200 per share would only have supported this statement, and could have actually misled shareholders into thinking that the market would actually support a price of $200 per share.

C.

Starkman's contention that Marathon should have disclosed more information regarding its search for a white knight and its negotiations with Steel are equally without merit. The SEC and the courts have enunciated a firm rule regarding a tender offer target's duty to disclose ongoing negotiations: so long as merger or acquisition discussions are preliminary, general disclosure of the fact that such alternatives are being considered will suffice to adequately inform shareholders; a duty to disclose the possible terms of any transaction and the parties thereto arises only after an agreement in principle, regarding such fundamental terms as price and structure, has been reached. *See* Item 7 of Schedule 14D-9, 17 C.F.R. § 240.14d-101 (1984); *Greenfield v. Heublein, Inc.*, 742 F.2d 751, 756-57 (3d Cir. 1984), *cert. denied*, ____ U.S. ____, 105 S.Ct. 1189, 84 L.Ed.2d 336 (1985) (rejecting an "intent to merge" trigger standard); *Staffin v. Greenberg*, 672 F.2d 1196, 1207 (3d Cir. 1982); *Reiss v. Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983).[9]

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9. *Greenfield v. Heublein* also held that Heublein's voluntary statement in response to a New York Stock Exchange inquiry that it knew of no reason for an unusual increase in trading activity in its stock when in fact it knew of ongoing merger negotiations was not false or misleading because the merger negotiations had not been formally disclosed and there was no indication that the information had been leaked or that insider trading had occurred. 742 F.2d at 759. This holding is directly contrary to the position taken by the SEC in that case as amicus that while a company may respond with "no comment" to stock exchange inquiries regarding unusual market activity, it may not state that no corporate development accounts for the stock activity when in fact it knows that merger negotiations are under way. This related position has not altered the Commission's longstanding policy that negotiations need not otherwise be disclosed unless an agreement in principle has been reached.

The rationale emerging from these cases is that when dealing with complex bargaining which may fail as well as succeed and which may succed on terms which vary greatly from those originally anticipated, the disclosure of preliminary discussions could very easily mislead shareholders as to the prospects of success, and by making public an impending offer, push the price of the target's stock toward the expected tender price, thereby depriving shareholders of the primary inducement to tender—a premium above market price—and forcing the offeror to abandon its plans or greatly increasing the cost of the offer. *See Staffin v. Greenberg*, 672 F.2d at 1207.

In the instant case, Marathon's shareholder recommendation letter and its Schedule 14D-9 stated that the company was considering a number of alternatives, including a merger with another firm. These statements adequately informed the shareholders of Marathon's plans. Additional statements in these documents to the effect that Marathon's board believed the best result would be for Marathon to remain independent were not misleading when read in their full context, and at most expressed a sincere hope which the board found unrealistic under the pressure of Mobil's offer.

Finally, Starkman's claims for fraud and breach of fiduciary duty are completely unsupported by authority in his brief, and were similarly neglected in his arguments below. We therefore affirm and adopt the reasoning of the District Court finding that no claim for fraud has been made out because Marathon did not fail to disclose any information necessary to make its other public statements not misleading, and that the directors' statements, made at a time of extraordinary pressure on the board, comported in all respects with federal law and did not breach a fiduciary duty to Marathon's shareholders.

Accordingly, the judgment of the District Court is affirmed.

Appendix C

No. C-1-82-13.

UNITED STATES DISTRICT COURT, S.D. OHIO, W.D.

Feb. 2, 1983

Irving and Charlotte RADOL, et al., Plaintiffs,

v.

W. Bruce THOMAS, et al., Defendants.

Jacob Stein, Cincinnati, Ohio, for plaintiffs.
John W. Beatty, Cincinnati, Ohio, for defendants.

ORDER GRANTING IN PART AND DENYING IN PART DEFENDANTS' MOTION FOR PARTIAL SUMMARY JUDGMENT

CARL B. RUBIN, Chief Judge.

This case involves the takeover of Marathon Oil Company ("Marathon") by United States Steel ("Steel"). This matter is before the Court on two Motions for Partial Summary Judgment, one by those defendants connected with Marathon and one by those defendants connected with Steel. As the arguments contained in each are virtually identical, the two Motions will be addressed as one. The Motion seeks summary judgment on all of plaintiffs' claims under the federal securities laws.

Facts[1]

The facts will be briefly summarized here. Where necessary, they will be expanded in the Court's discussion *infra*.

On October 30, 1981, the Mobil Corporation announced an offer to purchase up to 40 million Marathon shares for $85.00 per share in cash. The Directors of Marathon deter-

1. *See also Radol v. Thomas*, 534 F.Supp. 1302, 1304-06 (S.D.Ohio 1982) (Findings of Fact on Motion for Preliminary Injunction).

mined to resist the tender offer. In connection with this effort, they retained First Boston Corporation ("First Boston") to investigate specific alternatives to the Mobil offer, including the location of potential "white knights."[2]

As early as June of 1981, the management of Marathon made plans to resist a hostile takeover. An internal document variously referred to as the "Strong Report" and the "internal asset valuation" was prepared as an inventory of corporate assets with an estimation of their value. At approximately the same time, First Boston was directed to prepare a valuation of Marathon assets based solely upon information available to the public. The Board of Directors was advised of the conclusions reached in both the internal asset valuation and the First Boston appraisal at a board meeting held on October 31, 1981. During its negotiations with Marathon prior to the actual tender offer, United States Steel was also provided with copies of these reports.

The reports contained value estimates of Marathon's proven, probable and possible oil reserves. The values in the two reports varied by billions of dollars. The First Boston Report gave an "asset valuation" of $189 to $226 per share; the Strong Report valued Marathon's assets at $276 to $323 per share. The calculations used in arriving at the values involved factors such as original cost, carrying cost, replacement cost and discount cash flow. The calculations were based on speculation and assumptions which included economic predictions as far as 50 years into the future and projections of the future price of oil. Although the reports were prepared by experts, the methods used in calculating these values were necessarily imprecise.

The reports were not prepared in the ordinary course of business. Instead, they were intended to be "selling documents" for use in attracting more favorable tender offers.

The Board of Directors considered the Mobil offer to be "grossly inadequate" and made a diligent effort to develop an

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2. The term "white knight" refers to an alternative merger partner toward whom a corporation's management is friendly.

alternative transaction by contacting other corporations potentially interested in acquiring Marathon. During the same period of time, the United States Steel Corporation was seeking to diversify its holdings and was considering the acquisition of Marathon, among other investments. Steel apparently initiated the conversations with Marathon after the Mobil offer had been made. Discussions between Marathon and Steel began on November 9, 1981, and resulted in an Agreement of Merger signed on November 18. The negotiations were carried out at a time when the Mobil tender offer remained open.

The Steel tender offer was made public on November 19, 1981. Under the terms of the tender offer, Steel proposed to pay $125.00 in cash for 30,000,000 or approximately 51.12% of Marathon's outstanding shares.[3] For all other shares, both those tendered and not accepted, and those not tendered, Steel proposed a subsequent merger between Marathon and a wholly-owned subsidiary of Steel whereby each share of Marathon stock would be exchanged for a 12½%, twelve-year note of Steel with a face value of $100.[3]

Fifty-three million, eight-hundred eighty thousand, three hundred-sixty (53,880,360) Marathon shares, representing 91.18% of the total outstanding, were tendered in response to U.S. Steel's offer.[4] On March 11, 1982, the merger of Marathon and a wholly-owned subsidiary of Steel was ap-

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3. No precise value can be placed on these securities. At the end of 12 years, they will be exchangeable at par. At the time of the merger agreement, their value was deemed to be $86.00.

4. The original period for the U.S. Steel tender offer was extended by The United States Court of Appeals for the Sixth Circuit in *Mobil Corp. v. Marathon Oil Co.*, 669 F.2d 366 (6th Cir. 1981). In that action, Mobil challenged certain options granted to U.S. Steel in the Agreement of Merger. Under the Agreement, U.S. Steel was granted an option to purchase up to 10,000 common shares of Marathon for $90.00 per share, and an option to purchase Marathon's interest in the Yates Field for $2.8 million, if U.S. Steel's tender offer failed and another corporation succeeded in acquiring a majority interest in Marathon. The United States Court of Appeals for the Sixth Circuit invalidated these "lock-up options" under § 14(e) of the Exchange Act. 15 U.S.C. § 78n(e)(1981).

proved at a Marathon shareholders' meeting by the required two-thirds majority.[5] The second step of the Marathon-Steel Merger Agreement was subsequently carried out as planned.

Shareholders were first advised of the existence of the internal and First Boston asset valuations in the proxy statement relating to the merger vote, dated February 8, 1982. The proxy statement disclosed the range of net equity values of Marathon per share arrived at by each of the reports, and contained a disclaimer by the Board in each instance as to the reliability and relevance of the reports.[6]

Plaintiffs brought a class action, alleging, *inter alia*, various violations of the federal securities laws. Defendants have now moved for summary judgment with respect to those federal securities laws claims. The allegations at issue involve four main assertions, each of which will be dealt with separately.

Effect of Denial of Preliminary Injunction

This Court has previously denied plaintiffs' Motion for a Preliminary Injunction in this matter. *Radol v. Thomas*, 534 F.Supp. 1302 (S.D.Ohio 1982). Many, if not all, of the issues involved in the present motion were considered by the Court in connection with that earlier motion. It should be noted, however, that the applicable legal standard in considering a Motion for Preliminary Injunction—strong or substantial likelihood or probability of success on the merits—differs from the summary judgment standard. Therefore, the Court's earlier opinion does not necessarily control its consideration of this motion. See *Radol, supra* at 1318 (limited nature of Court's decision).

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5. On March 9, 1982, this Court denied a Preliminary Injunction to enjoin the proposed merger. See *Radol, supra*.

6. Specifically, the Board stated that the reports "were not viewed by Marathon's Board of Directors as being reflective of, and do not represent, per share values that could realistically be expected to be received by Marathon or its shareholders in a negotiated sale of the company as a going concern or through liquidation of the company's assets." (Pltfs.' Ex. I(D) p. 13).

Summary Judgment Standard

The summary judgment standard in this Circuit is a stringent one. Federal Rule of Civil Procedure 56(c) permits the Court to grant summary judgment only when there is no genuine issue of material fact and when the moving party is entitled to judgment as a matter of law. *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620, 64 S.Ct. 724, 88 L.Ed. 967 (1944); *Watkins v. Northwestern Ohio Tractor Pullers*, 630 F.2d 1155, 1158 (6th Cir. 1980). The Court may not make findings of disputed facts on a Motion for Summary Judgment. *Watkins, supra.* The movant has the burden of showing conclusively that there exists no genuine issue as to a material fact, and the evidence together with all inferences to be drawn therefrom must be considered in the light most favorable to the party opposing the motion. *Id.* The movant's papers are to be closely scrutinized, while those of the opposing party are to be viewed indulgently. *Id.* The Court will consider this Motion in accordance with the foregoing considerations.

Two-tier Merger As A Manipulative Device

Defendants seek summary judgment on plaintiffs' claim that the two-tier merger of Marathon and Steel was coercive and a manipulative device, in violation of Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e), and Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b).[7] Plaintiffs assert that there

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7. Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
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> * * *
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 14(e) provides, in pertinent part

> It shall be unlawful for any person to make any untrue statement of a

exist genuine issues of material fact with respect to this issue. The Court disagrees.

Plaintiffs' claim centers on the contention that the disparity in value between the $125.00 per share offered on the front end of the merger arrangement and the Steel notes exchanged on the back end acted to coerce Marathon shareholders into tendering at the front end in order to avoid a later freeze out at the lower value. This alleged coercion, according to plaintiffs, acted as a manipulative device in violation of §§ 10(b) and 14(e) by effectively depriving Marathon shareholders of the option of holding their shares for long-term appreciation and by contributing to "inefficiency in investment decisions." Plaintiffs rely on *Mobil Corp. v. Marathon Oil Co., supra,* in which The United States Court of Appeals for the Sixth Circuit held that two options granted by Marathon to Steel as part of the original merger agreement constituted "manipulative devices" in violation of § 14(e).

Plaintiffs reliance on *Mobil* is misplaced. The options involved in that case were an irrevocable option to purchase 10 million authorized but unissued shares of Marathon stock and an option to purchase Marathon's 48% interest in oil and mineral rights in the Yates Field. This latter option could be exercised only if Steel's offer did not succeed and a third party acquired control of Marathon. Thus, in effect, a competing offeror was precluded from acquiring Yates Field in a merger with Marathon. *Mobil, supra,* at 367. The Court concluded that these options prevented all other potential offerors from competing on equal footing with Steel, *id.* at 375, 376, and stated that the options, individually and in tandem, had the effect of "circumventing the natural forces of market demand in this tender offer contest." *Id.* at 376. The Court also held

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material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation.

that the fact that the options were fully disclosed did not prevent their being "manipulative devices" in violation of § 14(e). *Id.* at 376-77. The Court concluded its discussion with a word of caution:

> In so ruling, we do not purport to define a rule of decision for all claims of manipulation under the Williams Act, or indeed for all forms of options which might be claimed to "lock up" takeover battles or otherwise discourage competing tender offers. *Id.* at 377.

The situation at bar is not governed by *Mobil*. The two-tier tender offer and merger at issue here did not "circumvent the natural forces of market demand" in the manner of the options in *Mobil*.

As this Court has noted, any tender offer is likely to be coercive to some degree. *Radol, supra*, at 1312. The degree of "coerciveness" may increase as the disparity between the front end and back end of the transaction grows. Yet the Court is aware of no case in which such a disparity has been the basis for a finding of a violation of § 10(b) or § 14(e).

It is also clear that the two-tier arrangement did not discourage competing offerors. Mobil, in fact, responded to Steel's offer with an offer of its own, similar in price and structure. *See, Radol, supra*, at 1313.

While it may be true that "[t]he methods and techniques of manipulation are limited only by the ingenuity of man," *Cargill, Inc. v. Hardin*, 452 F.2d 1154, 1163 (8th Cir. 1971), *cert. denied*, 406 U.S. 932, 92 S.Ct. 1770, 32 L.Ed.2d 135 (1972), it remains the case that "manipulation is virtually a term of art when used in connection with securities markets. The term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476, 97 S.Ct. 1292, 1302, 51 L.Ed.2d 480 (1977) (citations omitted). The term does not cover all situations where shareholders may have been treated unfairly, *id.* at 477, 97 S.Ct. at 1302, and it does not cover the two-tier tender offer and merger at issue here.

This conclusion is buttressed by the fact that Congress has, by implication, acknowledged the existence of two-tier transactions and has regulated but not outlawed them, *see* 17 C.F.R. § 240.13e-3, and by the fact that the Court in *Mobil*, *supra*, allowed this very arrangement to proceed after striking out the invalid options. *See generally Radol*, *supra*, at 1312-13.

On this issue, defendants' Motion for Partial Summary Judgment will be granted.[8]

Tender Offer Material As Proxy Solicitations

Defendants also seek summary judgment on plaintiffs' claim that defendants' communications at the time of the tender offer are, in effect, proxy solicitations which violate § 14(a), 15 U.S.C. § 78n(a).[9] Plaintiffs first note defendants' argument that the two-tier tender offer and merger arrangement must be considered a unitary transaction for purposes of assessing the fairness of the deal. Plaintiffs then contend that the arrangement must also be considered a unitary transaction with respect to the application of proxy rules. They argue that, as a practical matter, shareholders were faced with the decision of whether to approve the merger at the time of the tender offer. Therefore, the materials disseminated by defendants in connection with the tender offer were, in effect,

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8. Plaintiffs argue that several individuals' opinions that the arrangement here was "coercive" or "manipulative" provide triable issues of fact which preclude summary judgment. This is not the case. The material facts are the details of the two-tier transaction, which are undisputed. The question of whether these facts constitute manipulative acts or practices is a question of law, amenable to disposition by summary judgment.

9. Section 14(a) provides

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 781 of this title.

proxy solicitations. The Court disagrees with plaintiffs' reasoning.

While it may be appropriate to consider the two-step transaction as unitary for the purpose of assessing its fairness,[10] it does not follow that it should be considered unitary with respect to the application of the proxy rules of § 14(a).

In evaluating the fairness of the choice confronting shareholders, it is clear as a matter of logic that the two options must be considered together. Shareholders were free either to tender or to accept the terms of the merger. Fairness must therefore be considered in the context of both available options, considered as a whole.

However, as this Court has previously noted, "a tender offer and subsequent merger are distinct acts with separate concerns toward which the securities laws and SEC Rules are directed in their regulatory schemes." *Radol, supra*, at 1314. Therefore, it is entirely appropriate to consider each step in such a transaction separately.

It is clear that the statements made in the tender offer and in the November 19, 1981, letter to Marathon shareholders from Director Hoopman were made in compliance with the securities laws and SEC Rules pertaining to tender offers. *Id.* As the Court has stated,

> To comply with these rules, U.S. Steel and Marathon referred to the merger agreement which would be proposed if the tender offer was successful. These references were not the equivalent of solicitations for the merger which would call forth application of the full panoply of the proxy rules. The proxy rules were applicable only when the merger step of the transaction began. *See Sheinberg v. Fluor Corp.*, 514 F.Supp. 133, 138 (S.D.N.Y. 1981). *Id.* (footnote omitted).

Here again, summary judgment is appropriate. The "ma-

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10. The Court expresses no opinion on the fairness of the transaction, an issue not before it at this time.

terial facts" are the tender offer and the materials distributed in connection therewith. The dispute involves a purely legal question. On this claim, defendants' Motion will be granted.

Rule 13e-3 and the Tender Offer

The third issue on which defendants seek summary judgment involves plaintiffs' claim that SEC Rule 13e-3[11], dealing with going private transactions, applied to the tender offer stage of the two-tier arrangement and required disclosure, at that time, of the First Boston and internal valuations, and plaintiffs' claim that the fairness opinions required by that Rule to be contained in the proxy statement were inadequate. On these claims, the Court finds that defendants are entitled to summary judgment.

As noted in *Radol, supra*, at 1304, it is undisputed that Rule 13e-3 applied to the merger stage of this transaction, and that defendants purported to comply with the Rule in their proxy satement. Plaintiffs claim, however, that the Rule also applied to the tender offer stage and required disclosure, in Steel's tender offer and supporting solicitations, of the First Boston and internal valuations.

Rule 13e-3 prohibits "fraudulent, deceptive or manipulative acts or practices," in connection with a going private transaction, by the issuer or an affiliate of the issuer, and sets forth certain requirements pertaining to filing, disclosure and dissemination of information in connection with such a transaction. *Radol, supra*, at 1310. *See also* 17 C.F.R. § 240.13e-3. "Affiliate of an issuer" is defined as

> A person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer. *For the purposes of this section only, a person who is not an affiliate of an issuer at the commencement of such person's tender offer for a class of equity securities of such issuer will not be deemed an affiliate of such issuer prior to the stated termination of*

11. 17 C.F.R. § 240.13e-3.

> *such tender offer and any extensions thereof.* 17 C.F.R. § 240.13e-3(a)(1) (emphasis added).

Plaintiffs contend that Steel was an affiliate of Marathon because, one day prior to the commencement of the tender offer, Steel allegedly acquired the requisite control over Marathon by means of the merger agreement entered into by the two companies. Additionally, they argue that the issue of control involves a factual determination which precludes the granting of summary judgment. In so arguing, they rely on SEC Release No. 34-17719, [1981] 2 Fed.Sec.L.Rep. (CCH) ¶23,709, which states:

> The existence of a control relationship with [the target company] does not turn solely upon the ownership of any specific percentage of securities. Rather, the question is whether there is the ability, directly or indirectly, to direct or cause the direction of the management and policies of [the target company], whether through the ownership of voting securities, *by contract* or otherwise. Id. at pp. 17, 245-35 and 36, n. 28 (emphasis added).

Plaintiffs argue that the negative covenants contained in the merger agreement gave Steel control over Marathon "by contract" within the meaning of the language quoted above.

The Court disagrees and holds that, as a matter of law, the negative covenants in question did not create in Steel a sufficient "ability, directly or indirectly, to direct or cause direction of the management and policies" of Marathon to rise to the level of control. Those covenants essentially required Marathon only to refrain from extraordinary corporate activity pending the merger and to use its best efforts to preserve intact its business organization. *Radol, supra,* at 1310. *See also id.* at n. 7 (description of specific convenants.)

Since Steel did not control, and was therefore not an affiliate of, Marathon at the commencement of the tender offer, Steel falls within the explicit exception created by the second sentence of Rule 13e-3(a)(1). As a result, Steel was not

an affiliate of Marathon during the period of the tender offer, and Rule 13e-3 did not apply to that stage of the transaction. Consequently, that Rule did not require disclosure of the First Boston and internal valuations at that time.

Plaintiffs also claim that the "fairness opinions" disclosed in the proxy statement by defendants pursuant to Rule 13e-3[12] were inadequate. They argue, in essence, that the fairness opinions[13] related to the transaction as a whole and not to the merger *per se* and were therefore misleading.

This issue was considered in *Radol*, *supra*, 1316-17. Upon re-examination, the Court finds no reason to deviate from that reasoning, which will not be repeated here. The Court concludes that the fairness opinions contained in the proxy materials were not materially misleading.

On the issues of the applicability of Rule 13e-3 to the tender offer and the sufficiency of the fairness opinions contained in the proxy materials, summary judgment will be granted for defendants.

Failure to Disclose Asset Valuations Under §§ 10(b) and 14(e) and Rule 10b-5

The last major issue on which defendants seek summary judgment involves plaintiffs' contention that the failure to disclose the First Boston and internal asset valuations in the tender offer materials violated §§ 10(b) and 14(e) and Rule 10b-5.[14] Plaintiffs argue that the question of the materiality of

12. Rule 13e-3(e)(1) requires the disclosure of various items listed in Schedule 13e-3, 17 C.F.R. § 240.13e-3. Item 8(a) of Schedule 13e-3 requires that the proxy statement "[s]tate whether the issuer or affiliate ... reasonably believes that the Rule 13e-3 transaction is fair or unfair to unaffiliated security holders." The statement is also required to "[d]iscuss in reasonable detail the material factors upon which the belief ... is based and, to the extent practicable, the weight assigned to each such factor." *Id.* at Item 8(b).

13. For the text of the fairness opinions, see *Radol*, *supra*, at 1316.

14. Sections 10(b) and 14(e) are set out *supra*, n. 7. Rule 10b-5 provides

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails,

the asset valuations must be submitted to a jury. Defendants contend that the valuations, based as they were on imprecise calculations and predictions, did not, as a matter of law, rise to the level of materiality. Here, in the context of a summary judgment motion, the Court agrees with plaintiffs.

As is evident from the language of § 14(e) and Rule 10b-5, omissions must involve *material* facts in order to be actionable. In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S.Ct. 2126, 2132-33, 48 L.Ed.2d 757 (1976), the Supreme Court discussed materiality,[15] stating

> The issue of materiality may be characterized as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts. In considering whether summary judgment on the issue is appropriate, we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. (footnotes omitted).

The *Northway* Court also formulated a general standard of materiality:

> An omitted fact is material if there is a substantial like-

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or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

15. *Northway* involved Rule 14a-9, 17 C.F.R. § 240.14a-9. However, the language of that Rule mirrors the operative language here in all significant respects and the *Northway* discussion is pertinent. *See, e.g., James v. Gerber Products Co.*, 587 F.2d 324, 327 (6th Cir. 1978).

> lihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with *Mills*'[16] general description of materiality as a requirement that "the defect have a significant *propensity* to affect the voting process." It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available. *Id.* at 449, 96 S.Ct. at 2132 (footnote omitted).

The Court cautioned, however, that "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good." *Id.* at 448, 96 S.Ct. at 2132.

In *James v. Gerber Products Co.*, 587 F.2d 324 (6th Cir. 1978), The United States Court of Appeals for the Sixth Circuit was confronted with a case involving nondisclosure of interim earnings figures. The Court stated, "Such sales figures, projections, forecasts and the like only rise to the level of materiality when they can be calculated with substantial certainty." *Id.* at 327. Defendants place heavy reliance on this statement, arguing that the asset valuations here, involving projections of up to half a century hence, reflect too great a level of uncertainty to meet the legal test of materiality.

The Court is unconvinced that the asset valuations are, as a matter of law, not material. It is conceivable that a "reasonable shareholder" would have accorded the valuations "actual significance" in his deliberations, even if disclosure would not have altered his decision. *See Northway, supra,* at

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16. *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 90 S.Ct. 616, 24 L.Ed.2d 593 (1970).

449, 96 S.Ct. at 2132. In any event, this is a question that is best left to a jury. Id. at 450, 96 S.Ct. at 2133. On this issue, defendants are not entitled to judgment as a matter of law, and summary judgment will be denied.[17]

Remaining Claims

Defendants also seek summary judgment on plaintiffs' remaining claims under the federal securities laws. The Court has examined these claims, which may be characterized as secondary, and the arguments of both sides, and concludes that, as to them, there exist no genuine issues of material fact and that defendants are entitled to judgment as a matter of law. On these remaining federal claims, summary judgment will be GRANTED.

Summary

For the reasons given above, the Court rules as follows on Defendants' Motion for Partial Summary Judgment:

With respect to the issue of whether the two-tier tender offer and merger was a manipulative device in violation of §§ 10(b) and 14(e), the Motion is hereby GRANTED.

With respect to the issue of whether the tender offer materials were proxy solicitations which violated § 14(a), the Motion is hereby GRANTED.

With respect to the issue of whether Rule 13e-3 applied to the tender offer stage of the two-tier transaction, the Motion is hereby GRANTED.

With respect to the issue of the adequacy of the proxy statement "fairness opinions," the Motion is hereby GRANTED.

With respect to the issue of the failure to disclose the First Boston and internal asset valuations at the tender offer stage, the Motion is hereby DENIED.

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17. This result is not inconsistent with the Court's earlier conclusion in *Radol, supra*. There, it was held that plaintiffs had failed to show a substantial likelihood of success on this materiality issue. *Radol, supra*, at 1308. That ruling was confined to the context of injunctive relief, *id.* at 1318, and does not dictate the decision here.

With respect to all remaining federal securities laws claims, the Motion is hereby GRANTED.

IT IS SO ORDERED.

Appendix D

Excerpt from S.E.C. Release No. 33-6332

Item 102. *Description of Property*

As the Commission has under consideration the entire area of oil and gas disclosure, it has determined to leave the Item substantially as it is at this time. Because the substance of paragraph (b) of Item 102, relating to the specific requirements for oil and gas enterprises is complex and industry-specific, the Commission is considering whether to delete it from Item 102 and to issue it as an Industry Guide. The Commission also is considering the possibility of permitting disclosure of less than proven or probable reserves with appropriate discussion. The Commission invites specific comment on these possible changes in oil and gas disclosure. It should be noted that in the interim, Instruction 4 to paragraph (b) of Item 2, relating to reserve disclosure, is proposed to be moved to new Instruction 5 to paragraph (a) and to be modified to reflect present Commission practice. As proposed to be revised, the Instruction would indicate the policy with respect to other extractive reserves, as well as oil and gas reserves, stating that except where it is shown to the staff of the Commission that reserves other than proven oil and gas reserves and proven or probable extractive reserves are required to be disclosed in the filing by foreign law or that the deletion of such reserve disclosure would render the document materially misleading, only proven oil and gas reserves and proven or probable extractive reserves may be publicly disclosed in a filing with the Commission. These limited exceptions are consistent with present staff practices. It should be noted that reliance on such exceptions will continue to require prior consultation with the Commission's staff.

The other changes proposed to the Item include a reorganization of the introduction and notes to paragraph (b) and a revision of paragraph (b) to call for three year information, rather than the five years currently required. The latter

change is intended to conform the Item to the recent changes made in Regulations S-K and S-X [17 CFR 210] to require three year segment information and income statements.[20]

20. Accounting Series Release No. 279 (September 2, 1980) [45 FR 63630].